CRIMES RELATING TO INCOME TAX IN INDIA

by

Krishna Deo Gaur
LL.M. (Allahabad)

Law School, Faculty of Law
Banaras Hindu University, India

Thesis submitted to the University of London
for the degree of Ph.D. in the Faculty of Law

School of Oriental and African Studies
UNIVERSITY OF LONDON

October 1971

A B S T R A C T

An attempt has been made in this thesis to study the various problems arising out of tax avoidance and tax evasion;their consequences and effects on the economy of the State and to suggest ways and means to discourage it

The first Chapter outlines the background in which tax crimes are committed in India today.

The second Chapter is devoted to a brief description of the origin of direct taxes in India and discusses the working of the Income Tax machinery.

A brief examination of the various practices adopted by ingeneous taxpayers to defeat the provisions of law in order to escape taxes has been made in Chapter three. The study of tax avoidance devices adopted by the Hindu undivided family is given particular attention.

A detailed analysis of the judicial attitude to tax avoidance in India and Britain has been made in Chapter four.

In the fifth Chapter an appraisal of the nature and extent of tax evasion has been made. The defects in legislation and administration have also been pointed out.

In the sixth and seventh Chapters legislative

provisions relating to penalties and prosecutions for tax avoidance and tax evasion have been discussed. The provisions relating to the application of the common law doctrine of mens rea in administrative and criminal sanction have been discussed and compared with the situation in other countries.

A judicial review of the provisions relating to the nature of penalty proceedings, burden of proof and the constitutionality of fiscal legislation has been made in Chapter eight.

This is followed by concluding remarks in Chapter nine.

ACKNOWLEDGEMENTS

I express my sincere thanks to all persons who have rendered assistance in the completion of this study.

I express my deep sense of gratitude and indebtedness to Professor Alan Gledhill, M.A.,(Cantab), LL.D (London), I.C.S. (Retd), Bar-at-law, Professor Emritus of Oriental Laws, University of London, who has been kind enough to supervise my work from the beginning to the end. Professor Gledhill has given invaluable suggestions and made critical comments from time to time. In fact, the work would not have been completed within a minimum prescribed period of two years but for the untiring efforts of Professor Gledhill in going through the manuscript, and his constant encouragement, It really has been a pleasure to work with him,

I express my sincere thanks to Professor J.N.D. Anderson, O.B.E., Director of the Institute of Advanced Legal Studies, University of London, for having awarded me a Research Fellowship at the Institute, which made this study possible.

I am thankful to Dr. K.L. Shrimali, Vice-Chancellor of the Banaras Hindu University, for having given me study leave in order to undertake this study.

I am deeply grateful to Professor Anadjee, Dean Faculty of Law, Professor M.P. Jain and Dr. R.P. Dhakolia, Banares Hindu University, for their encouragement and inspiration.

Sincere thanks are due to Dr. H.J. Fisher, adviser to students, School of Oriental and African Studies, who has very kindly obtained financial assistance for me from various institutions, which has enabled me to complete this work without interruption.

I am thankful to the British Council for paying fees on my behalf for the year 1970-71; to the Scholarships Committee, School of Oriental and African Studies; Yusuf Ali Turst; Dr. L. Hawtrey, British Students (Educational) Assistance Fund; Mr. B. Sh. Saklatvala, Chairman Northrook Society; Edwina Mountabatten Grants; Covenantors Educational Trust and Convocation Trust for their generous financial help.

I must express my thanks to the library staffs of the Institute of Advanced Legal Studies, the School of Oriental and African Studies, the Institute of Commonwealth Studies, the Senate House (University of London), the London School of Economics, the British Museum, India House and the India Office Library, for their kind co-operation and assistance.

I am deeply indebted to my parents and other relations for their constant encouragement to undertake this work.

I owe much to my wife, Madhu Gaur, the source of my inspiration. Her constant company, in being separated from her young children, dear Anshoo and Anuj in India, has been a great solace during my efforts to complete this work.

I express my thanks to Mr. S.K. Srivastava, Miss Usha Lokhami, Mr. Rajeev Dhavan, Mr. Jay, Mr. S.S. Srivastava, Dr. B.S. Kumar, Dr. P.S. Kumar, Dr. P. Singh, Mr. D.K. Jha, Mr. Athar H. Alvi, Mr. U. Khan, Mr. J.P. Agrawal, Dr. U.R. Rai for their constant help and encouragement during my stay in London.

I am thankful to Mrs. M. Cowen for her neat and good typing of my thesis. The typing could not have been finished in time but for her devotion to work.

ABBREVIATIONS

A.B.A	American Bar Association.
A.B.C.	Australian Bankruptcy Cases.
A.C.	Law Reports: Appeal Cases.
A.E.R.	The All England Reports.
A.I.T.	The Australian and New Zealand Income Tax Reports.
A.I.R.	All India Reports.
All.L.J.	Allahabad Law Journal.
A.L.J.	Australian Law Journal.
A.L.R.(2d)	American Law Reports (2nd series). Annotated.
A.T.D.	Australian Tax Decisions.
B.H.C.R.	Bombay High Court Reports.
B.I.F.D.	Bulletin for International Fiscal Documentation.
B.L.J.	Banaras Law Journal.
B.L.R.	The Bombay Law Reporter.
B.S.O.A.S.	Bulletin of School of Oriental and African Studies.
B.T.R.	British Tax Review.
Cr.App.Rep.	Law Reports: Criminal Appeal Reports. (English Reports).
C.B.J.	Canadian Bar Journal.
C.B.R.	Canadian Bar Review.
C.J.S.	Corpus Juris Secundum.

C.L.J.	Criminal Law Journal (INDIA)
C.L.P.	Current Legal Problems
C.L.R.	Commonwealth Law Reports (AUSTRALIA)
C.W.N.	Calcutta Weekly Notes
Can.Cr.Cases	Canadian Criminal Cases
Ch.D.	Law Reports: Chancery Division
Col.L.R.	Columbia Law Review
D. and Cl.	Law Reports: Dow and Clark's Appeals
D.L.R.	Dominion Law Reports (CANADA)
D.T.C.	Dominion Tax Cases (CANADA)
E.J.	Economic Journal
E.R.	Law Reports: English Reports
Ex.C.R.	Exchequer Reports (CANADA).
Ex.D.	Law Reports: Exchequer Division (U.K.)
F.I.C.C.I.	Federation of Indian Chambers of Commerce and Industry.
F.R.(2d)	Federal Reporter 2nd Series. (U.S. Reports)
F.S.	Federal Supplement (U.S.Reports).
Ford.L.R.	Fordham Law Review
Harv.L.R.	Harvard Law Review
I.C.L.Q.	The International and Comparative Law Quarterly
I.H.Q.	Indian Historical Quarterly
I.L.R.	Indian Law Reports
I.R.	Irish Reports
I.T.C.	Income Tax Cases

I.T.J.	Income Tax Journal.
I.T.R.	Income Tax Reports.
J.C.C.P.S.	Journal of Criminal Law, Criminology and Police Science.
J.C.L.	Journal of Criminal Law (BRITISH).
J.I.C.J.	Journal of the International Commission of Jurists.
J.I.L.I.	Journal of the Indian Law Institute.
J.P.	Law Reports: Justice of the Peace.
K.B.D.	Law Reports: King's Bench Division.
K.L.J.R.	Kerala Law Journal Reports.
L.C.P.	Law and Contemporary Problems.
L.Ed.	Law Report: Lawyers' Edition (UNITED STATES)
L.J.	Law Journal.
L.Q.R.	Law Quarterly Review.
L.T.R.	Law Times' Reports.
M.I.A.	Moore's Indian Appeals.
M.L.J.	Madras Law Journal (Reports).
Marq.L.R.	Marquettee Law Review.
Miami L.Q.	Miami Law Quarterly.
Mich.L.R.	Michigan Law Review.
Minn.L.R.	Minnesota Law Review.
Mod.L.R.	Modern Law Review.
N.D.L.	Notre Dame Lawyer.
N.S.C.	Notes on Supreme Court.

N.W.P.	North West Provinces High Court Reports,
N.Y.Univ.L.R.	New York University Law Review.
N.Z.L.R.	New Zealand Law Reports.
Neb.L.R.	Nebraska Law Review.
O.L.J.	Ohio State Law Journal.
O.L.R.	Ontario Law Reports (CANADA).
Or.L.R.	Oregon Law Review.
P.L.	Public Law.
Q.B.D.	Law Report: Queen's Bench Division.
S.A.L.R.	South Africa Law Reports.
S.C.	Law Reports Session's Cases (U.K.).
S.C.J.	Supreme Court Journal (INDIA).
S.C.R.	Supreme Court Reports (INDIA).
Sc.L.T.	Scots Law Times (U.K.).
T.C.	Tax Cases (English Reports).
T.L.R.	Tax Law Review.
T.R.	Taxation Reports (English Reports).
Tenn.L.R.	Tennessee Law Review.
U.M.L.R.	University of Miami Law Review.
U.S.	United States Supreme Court Reports.
V.L.R.	Victorian Law Reports (AUSTRALIA).
V.N.	Vyavahar Nirnaya (University of Delhi).

Ven.L.R.	Venderbilt Law Review.
Virg.L.R.	Virginia Law Review.
W.L.R.	The Weekly Law Reports (U.K.).
W.R.	Weekly Reporter (Calcutta).
Wis.L.R.	Wisconsin Law Review.
Y.L.J.	Yale Law Journal.

TABLE OF CONTENTS

.....

CHAPTER I

INTRODUCTION

Taxation, besides being a major source of revenue, is one of the most important weapons by which the State can mitigate two objectionable aspects of an unrestricted right to private property, firstly, the inequalities of wealth, and secondly, the power to use property for private profits, without regard to the community's interest[1]. In other words, taxation is an instrument for implementing an egalitarian, economic and social policy, redistributing income on a socially desirable pattern[2].

In India revenue from taxes constitutes 13 per cent of national revenue[3] and a substantial part of this comes from direct taxes[4]. This must be increased in the coming

---

1. '<u>Law in a Changing Society</u>', Friedmann (1959) p.85
2. K.C. Pant, Minister for Revenue and Expenditure, Government of India, 2nd All India Conference of Tax Executives, (1967) p.3.
3. B.R. Bhagat, Minister for Revenue and Expenditure, Government of India, 1st All India Conference of Tax Executives, (1966), p.1.
4. A little less than fifty per cent of total tax revenue, i.e., approximately 6 per cent of the total revenue of the Government of India comes from Direct Taxes, and about 96 per cent of which represents Income tax. See'<u>Report on Tax Administration in India', Foreign Tax Assistance</u>, U.S.A.I.D, India (1964), p.5. The percentage contributions from tax in relation to national income in other countries are as mentioned: Sweden 41.0 per cent, France 38.6 per cent, Austria 36.4 per cent, West Germany 34.9 per cent, U.K. 31.5 per cent, Italy 29.1 per cent, Canada 28.2 per cent, New Zealand 26.8 per cent, and Japan 19.3 per cent. See '<u>Fiscal Figures</u>', David B. Perry (1969) 17 Can. T.J. 207 at p. 208.

years, if the country is to achieve social and economic prosperity. A sound taxation policy and the whole-hearted co-operation of the taxpayer are essential. In other words, taxes should be just, equitable and directed towards the wider interests of every section of the community and the taxpayer should pay the tax due by him to the State without reluctance. Taxes should not be regarded as a confiscation of one's private property but as a fair contribution to the financial needs of the State. As Justice Holmes said, "taxes are what we pay for civilized society." He further stated, "I like to pay taxes. With them I buy civilization."[5] And Sir Leo Money once told the Royal Commission of Income Tax that taxes were the best expenditure he ever made and he got more satisfaction from them than any other expenditure incurred by him.[6]

However, there are persons who do not appreciate the importance of agricultural, industrial and commercial advancement, which can only be achieved by capital expenditure, financed by taxes. They do not realize that the goals of political freedom and a socialistic pattern of society, called for in our Constitution, requires every citizen to discharge his public obligation, in particular to pay his taxes, so that the welfare state can be established. But many people adopt unfair means to avoid and evade the

---

5. '<u>The Law and Practice of Income Tax</u>', J.B. Kanga and N.A. Palkhivala, 6th ed. (1969) Vol. I, b xix.
6. <u>Ibid</u>.

payment of taxes legally imposed by the State, thereby hindering the social and economic progress of the country. Such activities violate the Directive principles in the Indian Constitution. They include all possible methods employed to escape the impact of taxes lawfully imposed by legislation, by delay in payment of taxes, by tax avoidance and by tax evasion.

When fiscal legislation is before the legislature, the taxpayer, particularly the business magnates in the country, try to influence the legislature by lobbying and by propaganda, to secure their statutory immunity and concessions in their own interests to the prejudice of the general public. Some of the legislative reliefs asked for are the reduction of taxes, the liberalization of exemptions, the grant of credits, depletion and depreciation allowances and the creating of hitherto unrecognized allowances[7].

The practice of delay in payment of taxes has become a lucrative source of income, especially for taxpayers in the upper income group, such as businessmen, manufacturers and industrialists. They earn huge profits by investing unpaid taxes either in their own businesses or at high rates of interest. At the same time they petition Government to grant partial or total exemption from taxes, accumulated in millions, on the pretext of their inability to pay such huge sums.[8]

---

7. '<u>Tax Fraud and Evasion</u>', H.G.Balter, 3rd ed. (1963) p.2.
8. Government of India exempted Ram Ratan Gupta, an industrialist of Kanpur, from the payment of taxes amounting to several lakhs. Hindustan Times, May 10, 1966.

Tax avoidance indicates a defect in the law. It is a device by which a person, acting within the framework of the law, arranges his affairs in such a manner that he has either reduced his taxable income or has no income on which tax is payable. For instance, the act of representing one's mother as a partner in one's business in order to minimize one's income and to reduce tax liability by taking advantage of a provision of law meant to apply to a genuine partnership, is an act of avoidance of tax[9].

Tax evasion denotes defrauding the revenue by such illegal acts as concealment of income, or furnishing inaccurate particulars of income, or making a false return, or making false claims to allowances, in order to defeat the provisions of the law. For instance, if a man with a Swiss watch in his pocket says, to the Customs authorities at the Bombay Airport, "I have nothing to declare," he is evading customs duty, which he is bound by law to pay on taking the watch within the territory of India.

Tax avoidance and tax evasion have only a shade of difference[10]. The standard dictionaries of the English language treat the word 'evasion' and 'avoidance' as synonyms[11].

---

9. Re Central Talkies Circuit, Matunga, A.I.R. 1941 Bom.205.
10. 'Tax Evasion and Tax Avoidance', Montgomery B. Angell, (1938) 38 Col. L.J. 81.
11. Webster's International Dictionary of English Language (1930) p. 106; Chamber's Twentieth Century Dictionary (1968), p.71.

However, a distinction is drawn between them by the law, which regards the former as illegal and the latter as legal. And the Courts of law in most cases have upheld the right of the citizen and the resident to so arrange his affairs that he pays the minimum amount of taxes, by making use of loopholes in the law. Tax avoidance, therefore, has acquired a constitutional sanctity in most countries, including India.

Whatever may be the legal position, all these activities result in a colossal loss of revenue to the State in these times of grave economic emergency. They are for all purposes amongst the most important form of economic crimes or white collar crimes[12] and are as reprehensible as any other crime under the law of the land. But persons involved in tax-evading activities, recognized as criminals, are neither treated as ordinary criminals nor punished adequately; they are accepted by society as respectable and good citizens. This may be due to some defect in the law, or in the procedure, or in the enforcement machinery, or to the lenient attitude of the State, but it is also due to a regrettable social attitude of perversity or indifference, which imputes no shame to such activities and the bias of the judicial tribunals towards offenders from the well-to-do sections of the community.

---

12. '<u>Criminal Justice and Social Reconstruction</u>', Hermann Mannheim (1946), p. 145; <u>Report of the Committee on Prevention of Corruption</u>, 1964, Government of India, p. 271.

It is distressing to note that hardly any prosecution worth the name has been instituted in India during the last two and a half decades for illegal evasion of taxes.

This lenient attitude towards violators of the revenue laws leads to a number of undesirable consequences. People lose faith in the law and the democratic institutions of the country; they think there is one law for the poor and another for the rich. Feelings of frustration will increase when the honest, law abiding citizen is asked to assume the heavy burden cast on him by dishonest tax evaders, and this will ultimately lead to increase in crime.

No doubt tax avoidance and tax evasion are as old as taxes themselves and are prevalent in almost all countries of the world[13]. But they have multiplied enormously during the

---

13. 'Report of the Direct Taxes Administration Enquiry Committee 1958-59', Government of India, para. 7.2, p. 146; Messrs. Masukhlal v. C.I.T., Bombay, A.I.R. 1969 S.C. 1083, 1092. See 'Report of the U.K. Royal Commission on Income Tax, 1920, para 625, p. 135; 'Tax Evasion and Tax Avoidance: The Problems in the United Kingdom', (1954) 2, Can. T.J. 377, 378; supra note 10, p. 80; "German Tax Avoidance: Looking at Loopholes", 'Economist' Vol. 211, (1964 June 27); 'Taxation in Australia, Agenda for Reform', (1964), p. 128; 'Canadian Report of the Royal Commission on Taxation', Vol. III (1966) p.103 and Appendix A, pp. 537,578. 'Legislative Measures to Fight Tax Frauds in Norway', Kristian Straneby, (1953), 7, Bulletin for International Documentation, p.257; 'The Struggle Against Tax Evasion; The Situation in Denmark,' Hofrt-Lorenzen, 1953, 7, Bulletin for International Fiscal Documentation, p.8. 'Report of the Director of State Revenue: State of Israel (March 3, 1965), p.1; "Economic Crimes in the Soviet Union, (1964) 5, Journal of the International Commission of Jurists, p.1; 'Obstacle to a Revenue Administration in the Phillipines', Roman A. Cruz (1969) 10 The Tax Monthly, p.13, (Phillipines).

last two and a half decades in India since the achievement of political independence and have become a menace to society. As pointed out by the Committee on Prevention of Corruption:

> "The advance of technological and scientific development is contributing to the emergence of "mass society", with a large rank and file and a small controlling elite, encouraging the growth of monopolies, the rise of a managerial class and intricate institutional mechanisms. Strict adherence to a high standard of ethical behaviour is necessary for the even and honest functioning of the new social, political and economic processes. The inability of all sections of Society to appreciate in full this need results in the emergence and growth of white-collar and economic crimes, renders enforcement of the laws, themselves not sufficiently deterrent, more difficult .... Tax evasion and avoidance... evasion of economic laws, bribery and corruption, election offences and malpractices are some of the examples of white-collar crimes."[14]

These anti-social activities are by no standard less heinous crimes than those committed against the State under the Indian Penal Code.

The Government of India appears lately to be much concerned with these problems, With the result that it has referred the simplification and rationalization of tax laws and the search for ways and means to check tax avoidance and tax-evasion, prevalent on such an alarming scale in the country, to various committees and commissions. However, not much success has been achieved as yet.

A modest attempt, therefore, has been made in this thesis to study these problems in a wide socio-legal field in the hope of suggesting how the problem of tax crimes in

14. (1964) para 2.13, p.11.

India can be handled in a more co-ordinated, well arranged and scientific way and how the maximum amount of taxes can be effectively realized by the State, so that it can meet its commitments for the establishment of a welfare state.

The study of the subject is urgent, as India is facing enormous economic problems and its five year plans for the development and progress of the country have not produced the expected results. Moreover, there is no published work on the subject, in which the problems relating to tax avoidance and tax evasion have been examined in the light of judicial pronouncements.

The problem of tax crimes requires a comprehensive study of law, sociology, economics, psychology, politics and anthropology. This obviously is beyond the scope of the present study, which is mainly confined to the legal aspect of the problem, leaving the rest to be explored by others. Of course, the problems relating to equitable taxation, the importance of human relations and education of taxpayers are often emphasized.

As the title of the thesis indicates, the study has been limited to 'Crimes relating to Income Tax' only. This has been done to avoid confusion and to enable a more thorough examination of the provisions relating to tax avoidance and tax evasion.

A critical examination of the problem arising out of tax avoidance and tax evasion has been made. The various measures adopted by the Government, both administrative and legal, have been set out and their efficacy has been examined. The Courts' attitude to tax crimes, particularly in relation to tax avoidance in India and Britain, will be of interest to academic lawyers.

Though this thesis does not pretend to be a comparative study, a detailed review of similar provisions of law relating to tax avoidance and tax evasion in some of the major Commonwealth countries, namely, Britain, Australia, Canada, New Zealand, on the one hand and the United States of America on the other, has been made. The Courts' attitude in these countries in interpreting the statutory provisions relating to tax avoidance and tax evasion has also been examined.

At the close of the study, suggestions have been made for strengthening the administrative machinery, amending the law, educating the people in order to inculcate a sense of duty to pay their taxes, and for strictly enforcing penal provisions, in order to deter people from indulging in such anti-social crime; it is urged that the judiciary should change its traditional attitude, when interpreting the provisions of taxation legislation and give a liberal construction of such provisions, so that the intentions of the legislation may not be frustrated.

CHAPTER II

REVENUE COLLECTION

Taxation

It is a well recognized fact since time immemorial that the State needs money to finance its activities[1], to maintain its internal and external security and to run the administration for the well-being of its people. Taxation is one of the major devices[2] used

---

1. A Plea for Tax on Casual Income, R.N. Varma, Tax Consultant Conference Souvenir, (Jaipur) 1964 at p.13.

2. Prof. Wills: Constitutional Law of the United States: "The three great legislative powers usually exercised by the government are the power of taxation, the police power, and the power of eminent domain. The power of taxation may be defined as the legal capacity of government to impose charges upon persons or their property to raise revenue for governmental purposes. The levying of taxes is a legislative function; the determination of the amount of each individual's tax is an administrative function; but whether either function has been properly exercised is a judicial function". Quoted from The A.I.R. Commentaries; The Constitution of India: Chitaley, V.V. and Appu Rao, S., Vol.III, First Edition, (1956), Article 265, Note 2. Law in a Changing Society by W. Friedmann, (1959), London, Stevens and Sons, Ltd. at p. 85.

by the Government[3] to extract money or other valuable things[4] from people by securing the enactment of legislation for this purpose. Taxes are compulsory contributions to public funds, regardless of the presence or absence of a specific quid pro quo between the tax-payer and the public authority[5]. The essence of taxation is compulsion, i.e., it is imposed under statutory powers without the taxpayers' consent. Thus, a man cannot claim exemption from a tax to support educational institutions on the ground that he has no children to educate. Nor can a man claim or ask for adjustment of taxes to the amount of the services rendered to, or to the benefits enjoyed by

---

3. '<u>A Quarter Century of Direct Taxes in India 1939-64</u>,' Pophale, G.L.: Economic Research and Training Foundation, Bombay, p.24; <u>S. Narayanappa & Brothers</u> v. <u>I.T.O.</u> A.I.R. 1960 Mys. 40,42. <u>Report of the Indian Taxation Enquiry Committee</u> (1924-25), Vol.1 at p.6 enumerates some of the sources of revenue. They are - 1. State domain and tributes; 2. Fines and Penalties; 3. Business undertakings; 4. Fees and 5. Taxes. Tax Revenue constitutes 13 per cent of the national income of India, Bhagat, B.R., Minister of State in the Ministry of Finance, Government of India, Inaugural address report: First Tax Executives' Conference: Federation of India Chambers of Commerce and Industry, New Delhi (1966), at p.1.
4. The Government of Communist China imposes taxes on peasants assessed in units of grains produced, and it requires payment in grains itself. <u>International Encyclopedia of Social Sciences</u>, Vol.15 (1968) at p.521
5. '<u>The Burden of British Taxation</u>', Findley, G., Shirras and Rostal, L. The National Institute of Economic and Social Studies II Cambridge University Press, 1942, p.1, See '<u>Nigerian's Tax Efforts</u>'by A.O. Phillips (1970), British Tax Review, p. 180.

him. A poor man who pays the least may receive the largest benefit from public services as compared with a rich man, who contributes heavily in taxes, because the object of the government in a welfare State is to extend all benefits to every one equally, irrespective of caste, creed, colour and position in society. With this end in view, the burden is heavier upon those who are best able to bear it. In other words, as observed by the Supreme Court of India in Commissioner H.R.E. v. L.T. Swamiar:

> " A Tax ... is a compulsory exaction of money by public authority for public purposes enforceable by law and is not payment 'for services rendered'."[6]

Similarly, Cooley says in his book on 'Constitutional Law' that:

> "The word 'taxes' in its most enlarged sense, embraces all the regular impositions made by the Government upon the person, property, privileges, occupations and enjoyments of the people for the purpose of raising public revenue."[7]

---

6. A.I.R. 1954 S.C. 282 at p.295 (para.43). Economists in general have agreed that the two of the most important characteristics of a tax are: 1. that it is a compulsory payment made to the state, and 2. that there is no immediate quantitative relation between the tax paid by the individual and the service rendered by him to the State: See Report of the Indian Taxation Enquiry Committee (1924-25), Vol.I, p.7, for definition of tax.

7. Cooley's Constitutional Law (4th ed.), at p.61. Quoted from Narayanappa and Brothers v. I.T.O. A.I.R. (1960) Mysore 40 at p.42; See Corpus Juris Secundum Vol.83 (1953), 944.

Thus, the power of taxation is an attribute of sovereignity and is essential to the very existence of the State.

The power of taxation can only be exercised by the State through legislation, and it is this great constitutional principle that is embodied in Article 265 of the Constitution of India. Article 265 states that:

> "No tax shall be levied or collected except by authority of law."[8]

This means that not only the levy but even the collection of a tax [9] must be under an authority of

---

8. In England this principle was established as long ago as 1215 in Magna Carta and finally affirmed by the Bill of Rights (1869) in the following words: "Levying money for the use of the Crown by pretence of prerogative without grant of Parliament is illegal "; In the United States of America, Article 1, section 8 (i) of the Constitution makes it abundantly clear that; "The Congress shall have the power to levy and collect taxes, duties, imposts and excises..."

9. The Constitution of India has laid down the procedure for such purposes in Articles 110,117,123,199,207 and 213, which must be strictly complied with in order to validate the levy or collection of the tax: Zila Parishad Moradabad v. K.S. Mills, A.I.R. 1968 S.C. p.98 at p.100; M. Mohammad Ishawk v. C.I.T., Delhi, Ajmer-Merwara, A.I.R. 1954 Punjab 296 at p.297 (para 7). The Court held that if an Income-tax Officer recovers tax except in accordance with the procedure established by law, it would amount to taking property in contravention of the provisions of Article 31 of the Constitution. The Constitution of India in Item 82 of List I of the 7th Schedule has provided for the imposition of Income-tax. The provision is wide enough to include not only legislations for levying of tax but also as authorizing an enactment which prevents the tax imposed from being evaded. See Baldeo Singh v. C.I.T., Delhi A.I.R. 1961 S.C. 742; Balaji v. ITO, Special Investigation Circle, A.I.R. 1962 S.C. 123.

law[10]. Thus a tax can only be imposed by a law, which is valid according to the relevant provisions of the constitution[11], viz., (i) the law must be within the legislative competence of the legislature, being covered by an item in the legislative list assigned to it by the constitution[12]; (ii) the law must be validly enacted, i.e., by the proper body which has the legislative authority to legislate on the matter, and in the manner required by law to give its acts the force of law[13]; (iii) the law must not violate Article 13[14] of the constitution or any other constitutional limitations. In other words, the law

---

10. 'Law' in this Article refers to statute law or law made by the legislature. A customary imposition is no longer valid. State of Kerala v. Joseph, A.I.R. 1958 S.C. 296.

11. See 'Commentary on the Constitution of India, D.D. Basu, 5th ed.Vol.4, pp.238 to 260.

12. The Constitution of India, Schedule VII, provides three lists enumerating matters on which the central and state legislatures can make laws. They are as follows: List I: Union List: Entries 82-92A: Parliament can make laws on matters relating to taxes mentioned in the said entries. List II: State List: State legislatures can make laws relating to taxes mentioned in entries 45 to 63. List III: Concurrent List: Both the Parliament and the State legislatures can make laws. Entries 35 and 44 deal with taxes.

13. Bharat Kala Bhandar v. Dhamangaon Municipality, A.I.R. 1966 S.C. 249 (262).

14. Balaji v. I.T.O., A.I.R 1962 S.C. 123 (128). Khandige Sham Bhat v. Agricultural I. T. Officer. A.I.R. 1963 S.C. 591,594; Purshotam Goundji Halai v. B.M. Desai Add. Collector, Bombay, A.I.R. 1956 S.C. 20; Thangal Kunju Musaliar v. Venkatachalam, A.I.R. 1956 S.C. 246, 262.

should not be such as to infringe any of the fundamental rights guaranteed to the people under part III of the constitution, such as that in Article 14[15], Article 19 (1) (a)[16], Article 19 (1) (f)[17], and Article 19 (1) (g)[18], Article 20[19], Article 21[20], Article 289 or Article 303. However, the constitution does not prohibit the retrospective imposition of a tax.[21]

The principal of 'No taxation save by authority of law' is so well guarded by the courts that they would not infer the grant of a power to tax from any legislation in the absence of a clear expression. The courts have never hesitated to strike down a taxing act, if the taxing power is colourably exercised by the State for the enforcement

---

15. Kunnathat Mopil Nair v. State of Kerala, A.I.R. 1961 S.C. 552.

16. Express Newspapers v. Union of India, A.I.R. 1958 S.C. 578 , 614 .

17. Jagannath Baksh Singh v. State of U.P., A.I.R. 1962 S.C. 1563, 1570-72 .

18. Supra note 15.

19. Maqbool Hussein v. State of Bombay A.I.R. 1953 S.C. 325; R. Prasad Mohanlal v. I.T.A. Tribunal, A.I.R. 1970 620,624,625,(F.B.) N.A. Malbury and Brothers v. C.I.T. Bombay, A.I.R. 1964 S.C. 1807.

20. Purskottam Govindji Halai v. B.M. Desai Add Collector of Bombay, A.I.R. 1956 S.C. 20; Collector of Malabar v. E. Ebrahim, A.I.R. 1957 S.C. 688.

21. World Tax Series: Taxation in India : Harvard Law School (1960) p.44 para 1/4.1.

of a forbidden power. On this point the courts in both India[22] and the United Kingdom[23] have taken a similar stand and have declared taxing laws ultra vires, if not enacted strictly according to law. However, the power of taxation belongs exclusively to the legislature, and the courts can interfere only if the taxing power overrides the constitutional provisions.

Taxes, besides being a means of raising revenue to finance governmental expenditure, are a major instrument for implementing the economic and social policy of the State. Broadly speaking taxes are an instrument in regulating consumer purchasing power in relation to goods and services, by providing incentives for production, investment and saving, and influencing the balance of payments and the structure of economy, as well as

---

22. Yasin v. Town Area Committee, (1952) S.C.R. 572. The Town Area Committee framed two bye-laws (1 and 4b) to charge fees from persons, who sold or purchased vegetables or fruits within the local area. The bye-laws were framed under sections 293 and 298 of the U.P. Municipalities Act, 1916, which empowered the Town Area Committee to make bye-laws to charge fees for the use and occupation of any property vested in or entrusted to the management of the Town Area Committee. Bye-laws 4(b) provided that any person can sell wholesale at any place in the town area, provided he paid the prescribed fee.
The court held that the bye-laws were ultra vires, for the Act did not empower the committee to charge any fees, otherwise than for the use or occupation of any property vested in or entrusted to the committee. But the bye-laws in effect forbid a person from using any land or place within the limits of the committee, without payment of the prescribed fee.; Lokmanya Mills v Barsi Borough Municipality, A.I.R.1961 S.C. 1358, 1360-61.
23. Attorney General v. Wilts United Dairies (1922) 127 L.T. 822.

contributing directly to the long term growth[24]. As a result of taxation a balance is created in the spending potential of the private and public sector. Wealth is in a way redistributed when persons are asked to contribute to the exchequer in the form of taxes in a fixed proportion, determined by law, according to their capacity.[25] Thus, taxes are increased in time of war and emergency to subdue inflation and reduced in time of depression to stimulate production. It may not be out of place to quote a passage from Encyclopedia Britannica, which summarizes the objectives of the law of taxation in a very simple and clear language

---

24. "Social Effects of Fiscal Legislation with Special reference to Devaluation" by Debi Prasad Pal, J.I. L.I., (West Bengal State Unit), Vol. 3, p. 163; 'The British System of Taxation', Central Office of Information Reference Pamphlet 10. H.M.S.O., London, (1969) at p.4; 'Tax Reform Proposals in New Zealand, (1968) 16 Canadian Tax Journal p.146.

25. 'Tax and Social Benefits' The Accountant, March 12, 1970, at p. 361 (Vol. 162 No. 4969); see 'Incidence of Taxes and Social Service Benefits in 1968: Economic Trends': Study from the Central Statistical Office Treasury Publication (quoted in Accountant at p.361 stated above); 'The Use of Tax System to Achieve Economic and Social Objectives' (1967) 15 Canadian Tax Journal, pp. 112 to 130.

in the following words:

> " The pervading objective of taxation, in concert with other government policies, is to promote the general welfare. Taxes contribute to this end by providing the financial foundation for the substantive function of the government and at the same time serving as an engine of social and economic betterment, which nations can call upon to reduce excessive inequalities of wealth, to check inflation and war profiteering, and to promote economic stability."[26]

The word "tax" in Article 265 of the constitution has been used in a wide and comprehensive sense to include any 'impost', - general, special, or local[27]. As the Supreme Court of India in Muhammadbhai v. State of Gujarat[28] has said, 'tax' includes not only 'taxes' but also 'fees', 'duties', 'cesses' etc. However, schedule VII of the constitution has used 'tax' in the entries in the legislative list in a restricted sense, distinguishing it

---

26. 'Encyclopedia Britannica'(1967), Vol. 21, at p.725; see 'Taxation and Foreign Investment: A Study of Taxation Laws in India in Relation to Foreign Investment', National Council of Applied Economics Research, New Delhi (1957), p.2; 'Inaugural Address' by K.C. Pant, 3rd All India Conference of Tax Executives' (1968), pp. 8,9; 'Report of the Working Group on Central Direct Taxes': Administrative Reforms Commission, (1968) at p.137 (para 7.8).

27. Constitution of India, Article 366 (28) provides that "Taxation" includes the imposition of any tax or impost, whether general or local or special, and "tax" shall be construed accordingly". This is the reproduction of Item 17 of section 311 (2) of the Government of India Act, 1935.

28. A.I.R. 1962 S.C. 1517 at p. 1530.

from 'fees', 'duty' and 'cess'.

A 'fee' is a payment levied by an appropriate authority in respect of some privilege or special services performed by such authority for the benefit of the individual.[29] For example, if a local authority, say the Borough of Islington, makes it obligatory on the part of those, who want to use a vehicle in its jurisdiction, to take out a licence for the purpose and pay a certain amount for it. The amount is termed a 'fee' (licence fee) and not a 'tax', because the taking of a licence is not obligatory, unless, of course, one uses the vehicle within its jurisdiction.

The licence holder would derive special benefit by virtue of holding the licence, i.e., he can use the vehicle within the local limits of the borough, which others not having a licence could not do. Thus, there is always an element of quid pro quo between the authority charging the fee and the person paying the fee, which is lacking in case of a tax. Further, a fee is a voluntary payment and the payment is usually related to the special benefit available to the payer of the fee, unlike a tax, which is a compulsory exaction of money, with no particular advantage to the tax payer. However, a tax is generally levied, taking into consideration the payer's capacity to

29. Commissioner of Hindu Religious Endowment v. L.T. Swamiar, A.I.R. 1954 S.C. 282 at p. 295 (para 44)

pay, whereas in imposing a fee, as a rule no account is taken of the abilities of the different assessees.[30]

The distinction between a 'tax' and a 'fee' is of special significance under the constitution in determining the legislative competence of the legislature imposing the 'tax' or 'fee'. As the power to levy various kinds of impositions has been distributed by the various entries in the legislative lists, the validity of the impositions made by a particular legislature has to be judged with reference to those entries; for instance, some of the entries in the legislative lists refer to 'taxes' while

---

30. A fixed rate of fee is levied for everyone irrespective of the payer's capacity, for instance, court fee, licence fee, tuiton fee etc., are charged equally from everyone.

some others to 'fees'[31]. Accordingly, the courts have to enquire into the real nature of the impost in order to judge the legality of the legislation in question[32].

---

31. See Entries (in Lists I,II, and III) of Schedule VII for 'fees' and 'taxes'. See <u>supra</u> note 12. For entries relating to taxes and for fees see List I entry 96, list 2, Entry 66 and list 3, Entry 47.

32. <u>The Commissioner of Hindu Religious Endowments</u> v. <u>Lakshmindra Thirtha Swamiar</u>,(1954) S.C.R. 1005 (S.C.), A.I.R. 1954 S.C. 282. The Supreme Court held that the levy of an annual fee on all religious institutions, fixing the maximum rate at 5 per cent of the income derived by them, was not a 'fee' but a 'tax', because the legislation was not covered by entry 47 of the list III. The Madras State Legislature had imposed a sum of fee under section 76 of the Madras Hindu Religious and Charitable Endowments Act (19 of 1951). The Supreme Court held that, although the impugned section spoke definitely of the contribution being levied in respect of the services rendered by the government, there was total absence of any co-relation between the expenses incurred by the government to the amount raised by contribution. Their Lordships observed that: "...The material fact which negatives the theory of fees in the present case is that the money raised by levy of the contribution is not ear-marked or specified for defraying the expenses that the Government has to incur in performing the services. All the collections go to the Consolidated Fund of the State and all the expenses have to be met not out of these collections but out of the general revenues by a proper method of appropriation, as is done in the case of other Government expenses. That in itself might not be conclusive, but, in this case there is a total absence of any co-relation between the expenses incurred by the Government and the amount of money raised by contribution under the provision of Sec. 76 and in these circumstances the theory of return or counter-payment or <u>quid pro quo</u> cannot have any possible application to this case." (p. 296, para. 49).

A 'duty' is a tax levied on goods or commodities. In other words, 'duties' are not direct taxes[33]. As said by D.D. Basu in his 'Commentaries on the Constitution of India[34]', duties may be classified as excise[35], customs[36], tolls[37] or transit duties[38] according to their nature.

A 'cess' is a tax levied for a specific purpose often with a prefixed word defining the object[39]. For instance, the tax levied on cotton produced in India for

---

33. Infra p. 24 for the definition of direct taxes.

34. Volume 4 (5th edition) 1968 at p.255.

35. It is a duty levied upon a manufacturer or producer, in respect of the commodity manufactured or produced. Thus, it is a tax upon goods and not upon sales or the proceeds of sales of goods: Governor General v. Province of Madras, A.I.R. 1945 PC 98. Central Government can levy excise duty under entry 84 List I on (a) tobacco; and (b) medicinal and toilet preparations containing alcholic or opium, hemp or other narcotic drugs and narcotics.
State Governments can levy excise duty under entry 51, List II on (a) alcoholic liquor for human consumption and (b) on hemp and other drugs and narcotics.

36. "Customs duty is a duty on the importation or exportation whether by land or sea". Commonwealth Oil Refineries, Ltd.v. S. Australia, (1926) 38 C.L.R. 408. List I Entry 83 empowers the Federal Government to levy custom duties upon commodities exported out of India and imported into India from other countries.

37. Halsbury's Laws of England, 3rd edition, Vol.25 para 767 at pp.394-395. Toll has been defined as "... A sum payable by the buyer upon sales of...articles in a market or fair."
List II entry 59 authorizes the State legislatures to levy a toll tax for the use of a market, or a bridge, or the temporary use of a land. Sita Ram v. Janapada Sabha, A.I.R. 1952, Nagpur 401.

38. It is a tax imposed on the transaction of goods from one place to another.

39. Gwalior Sugar Co v. State of Madhya Bharat, A.I.R. 1954, Madhya Bharat 196 (D.B.).

'the creation of a fund to be used for the improvement and development of the growing, marketing and manufacturing of cotton in India' is termed a cotton cess[40].

'Taxes' are to be distinguished from'prices' imposed by the government for goods and services rendered as a condition for obtaining it. The 'price' is proportionate to the amount of services and goods rendered. For example, if the government supplies water or electricity to the public, the price is based on the cost of production and the amount used by the consumer[41]. This is the 'price' not a 'tax'.

Taxes may be classified for various purposes in different ways. For example, direct and indirect[42]; local and national; proportional, regressive and progressive[43]; taxes in <u>rem</u> and in <u>personam</u>[44]; personal or business;

---

40. Indian Cotton Cess Act, 1923; Agricultural Produce Cess Act, 1940; Lac Cess Act, 1930 imposes a cess on lac produced in or exported from India.

41. <u>International Encyclopedia of Social Sciences</u>: Vol. 15 at p.521. Macmillan and Free Press.

42. See <u>King</u> v. <u>Caledonian Collieries Ltd</u>. A.I.R. 1928 P.C. 282. Sales tax is one of the indirect taxes. Income-tax is the typical example of direct tax.

43. The distinction depends upon the ratio of tax liability to net income. The tax is termed progressive, if the rate of tax rises with the rise in income; proportional, if the ratio is constant; regressive, if tax declines as income rises: <u>Encyclopedia Britannica</u>, Vol. 21 (1967) at p.724.

44. <u>Ibid</u> p. 724.

specific and ad valorem [45] etc. Since it is proposed to discuss crimes relating to income tax, which is one of the most important direct taxes, the distinction between direct and indirect taxation needs explanation. The distinction between the two is mainly administrative. Direct taxes are those which are intended by the legislature to be paid directly by the tax payer to the proper authorities, whereas indirect taxes are intended to be realised from the tax payer indirectly through non-official intermediaries along with the price or otherwise. In other words:

> "A direct tax is one, which is demanded from the very person who it is intended or desired should pay it. Indirect taxes are those which are demanded from one person in the expectation and intention that he shall indemnify himself at the expense of another." [46]

Thus, Income tax, Corporation tax, Surtax, and Profit

---

45. Ibid p.725. A tax or duty is specific, when it is based on some physical measurement or quality, e.g., so much per pound, per yard or per gallon. It is ad valorem when it is based on value and levied as a percentage of that value, for instance, 1.5 per cent of property value.

46. Mill: Principle of Political Economy, p.823. Quoted from 'Justice in Taxation in India', Lakdawala, Popular Book Depot, Bombay, at p. 23

tax are classified as direct taxes[47], because tax is paid directly to the taxing authority by tax payers; whereas Sales tax, Purchase tax Excise and Customs are termed indirect taxes, since such taxes are realized and collected by tax authorities from the manufacturers or sellers of the product, though paid by the customers on what they purchase.

Direct Taxes in India

The history of Direct taxes in India is a fascinating subject. Direct taxes are not a novelty in India introduced by the British[48], as is too commonly supposed. Nor is this the outcome of the 19th and 20th century civilization as in other countries of the world[49].

---

47. Some of the other direct taxes are; The Wealth Tax Act, 27 of 1957; The Estate Duty Act (34 of 1953); The Gift Tax Act (18 of 1958). The Expenditure Tax Act, (29 of 1957), repealed from 1966-67; The Excess Profit Tax (15 of 1940). See Report of the Working Group on the Central Direct Taxes Administration: Administrative Reforms Commission (1968), p.3.
48. Report of the Direct Taxes Administration Enquiry Committee (1958-59), Government of India, p.1. 'A Quarter Century of Direct Taxes in India (1939-64), Paphle, G.L.: Published by Economic Research and Training Foundation, Bombay, p.2; see J.P. Niyogi.'The Evolution of the Indian Tax System': Studies in Economics and Political Science No. 12 (L.S.E. (1929), p.4; 'The Liabilities of Deities to pay taxes, J. Duncan M. Derrett (1969) Bombay Law Journal 38 at p.39. See 'A History of Indian Taxation', P. Banerjea (1930), (Macmillan & Co., London) pp.77-160.
49. Income Tax was introduced in U.K. in 1799 and finally became a permanent feature in 1842; in U.S.A. 1913; in Austria 1849; in Italy 1864; in Australia, New Zealand and Japan 1880's; in Germany and Netherlands 1890's; and in the rest of the countries of the world in the 20th century: International Encyclopedia of Social Sciences, Vol. 15 (1968) at p. 529.

Direct taxes were ancient and well known and recognized institutions in India since time immemorial[50]. For instance, as noted by Professor S.S. Khera, 'Agricultural taxes were an extremely sensitive area of the economic and social policy ... in India'[51] in the early days. Persons were asked to pay taxes[52] to meet the expenses of the State and no unequal treatment between the cultivators and traders, poor and rich could subsist under the system[53].

However, the system of direct taxation by a modern income tax in its present form was first introduced in India by the then British Government in the year 1860[54]. It was probably introduced to meet the financial difficulties consequent on the mutiny of 1857[55]. This in fact

---

50. '<u>The Law of Income Tax in India</u>': Sundaram, V.S. IVth edition, Butterworth & Co. (India) Ltd., p.7. <u>Report of the Direct Taxes Administration Enquiry Committee</u> (1958-59), Government of India, p.1.

51. <u>District Administration in India</u>, 1964, p.171. (Asia Publishing House, London).

52. <u>Supra</u> n.50. p.1. The State's share of income from the land was fixed in between 1/12th and 1/6th depending on the quality of the soil and the amount of labour expended on cultivation.

53. <u>Supra</u> note 50, pp. 1-7. Some of the sources of revenue were like <u>sita</u> (profits from crown lands), <u>bhaga</u>, (portion of profit payable to Government), <u>bali</u>, (religious taxes), <u>kara</u> (taxes paid in money), <u>Vartani</u>, (road cess etc.), <u>Mula</u> (capital), <u>Vyaji</u>, (premia), <u>Atyaya</u> (fixed fines) etc.

54. <u>Report of the Indian Taxation Enquiry Committee</u>, (1924-25), Vol.1, p.189.

55. <u>Ibid</u>. p.189

adumbrated the introduction of progressive direct taxation in India; it may be reckoned as the most important change in the modern times in the Indian taxation system.

The Income Tax Act 32 of 1860 was based on the English system of taxation[56] which was unsuited to the then Indian conditions, beside being complicated and unworkable[57], with the result that a number of legislative changes were made in the Act on one pretext or another, so that, within a short span of 26 years 1860-1886, 23 Acts dealing with taxes on income were passed[58]. In this period

---

56. In the United Kingdom the tax on income was first introduced by Pitt in 1799 as a temporary measure to finance the Napoleonic War. The Act was repealed in 1802 after the end of the war. However, the tax was reintroduced in 1803 by Addington and continued up to 1816 after the Battle of Waterloo. Thus, from 1816 to 1842 there was no income tax in Britain. In 1842 the tax was revived by Lord Peel in order to reduce import duties on various articles and has been imposed ever since, with modifications from time to time. The Act of 1842 was modified, firstly, by Gladstone's Act of 1858, which remained the basic law of income tax until 1918. In 1918, 1952 and 1970, the first second and third Consolidation Acts were passed, which made major changes in law. The present law of Income tax is the Income and Corporation Taxes Act (1970 c 10): '<u>British Tax Encyclopedia</u>: Wheatcroft, G.S.A., Vol.I, 12th ed. para 1-011 at p. 1007.

57. <u>Supra</u> note 54 at p.189.

58. <u>Supra</u> note 48 at pp. 1-2.

the legislation was in a rudimentary form passing through an experimental stage and it was only in 1886 that income tax became a permanent feature of the Indian system of taxation. The Income Tax 2 of 1886 remained in force for thirty-two years, i.e. up to 1918. Of course, the Act was amended from time to time, to suit changes in society and to fulfil the economic needs of the Government[59].

Some of the important features of the tax were that agricultural income as well as charities were exempt from taxes. The tax was levied on a flat rate basis[60]. The administration was done by the Land Revenue Officers, except in big cities like Calcutta, Bombay and Madras. In general, there was no obligation to file a return, except

---

59. Supra note 48 at p. 5-6. The rate of tax was 2 per cent on'salaries' and 'on interest on securities' between Rs. 500 and Rs. 2,000. In 1903 the taxable minimum was raised to Rs. 1,000 per annum. The financial stress of the First World War made it essential to make the tax more productive. Accordingly, in 1916 a sort of 'step' basis of tax was introduced in place of 'flat' rate basis. Thus, the gradation was made steeper and the rates increased substantially. It was made obligatory on the part of assessees having income over Rs. 2,000 to make a return and penalties were provided for failure to file a return or for making a false return. In 1917, a Super Tax Act was passed. The tax was levied on a slab basis on income over Rs. 50,000. The same rates were levied on Companies and individuals, as well as on the Hindu Undivided families.

60. Supra note 50 at p.10.

for companies. The Act 2 of 1886 is one of the most important pieces of legislation in the history of Indian taxation, not only because it made a departure from the past, in as much as it gave a uniform pattern to the law of income tax and brought about stability in the law, but also because it contained the germ of the general structure of subsequent legislation, including the present Income Tax Act of 1961.

In 1918, a new income tax Act, 7 of 1918, was passed repealing the previous Act. However, this Act only survived for the brief period of four years, and in the year 1922 a new Income Tax Act,11 of 1922 was passed[61], which came into force with effect from April 1, 1922. At this time income tax was a central subject. Two important features of the Act of 1922 were that the rate of taxation was left to be decided every year by the Finance Act, and secondly, that it was the first step in the disengagement of the provincial governments from administering central subjects[62]. The Act of 1922 continued in force up to 1961, though it was amended

---

61. Supra note 50 at p.12. The Government of India appointed an All India Committee in 1921 and the recommendation of this Committee formed the basis of the Act of 1922.

62. Ibid at p.14.

considerably from time to time, notably by an Act of 1939[63]

It is interesting to note that the Government of India has been concerned since the inception of tax legislation in the country to make the law simple, easy, free from technicalities in assessment and collection of taxes, and comprehensible by the common man. With this object in view, the Government has appointed numerous committees and commissions from time to time to examine the structure and functioning of central, state and local taxation, as related to the economic and social objectives of the country and to make recommendations for modifications of the tax system and for the addition of new methods of taxation. Among the more important reports on the subject after the close of the Second World War, which were responsible for the change in the law of income tax in India from time to time and which led to the enactment of the Income Tax Act of 1961, are the following:-

---

63. The Government of India appointed a committee of three known as 'Experts Committee' in October, 1935, 'to make an investigation of the Indian Income Tax system in all its aspects and report on both the incidence of the tax and efficiency of its administration'. The Committee gave its report on 24 Dec. 1936. In the light of its recommendations, the Act of 1922 was thoroughly amended in 1939 by the Indian Income Tax (Amendment) Act 7 of 1939.

The first report is that of the Investigation Commission, 1947. A Commission was constituted under Section 3 of the Taxation on Income (Investigation Commission) Act, 30 of 1947[64], which gave its report on December 29, 1948. As a result of its recommendations, the Indian Income Tax (Amendment) Act, 15 of 1953 was passed with retrospective effect from April 1, 1952. In addition to this, other amendments were made in the Act 11 of 1922[65].

The second report is that of the Taxation Enquiry

---

64. Report of the Income Tax Investigation Commision, (1949), at p.5. The Commission was called upon (i) to investigate and report to the Central Government on all matter relating to taxation of income, with particular reference to the extent to which the existing law relating to and procedure for assessment and collection of such taxation is adequate to prevent the evasion thereof; (ii) to investigate any case or points in a case referred to it by the Central Government under Section 5 of the Act. See *infra* pp. 491 to 504 for cases.

65. *Ibid* p.26. Sections 34 and 46 of the I.T. Act, 1922 were amended and a new sec. 33B was added by the Income Tax and the Business Profit Tax Act, 1948, with effect from April 1, 1948.

Commission, 1953[66] headed by Dr. John Mathai, an ex-Finance Minister of the Government of India, which submitted its recommendations to the Government in 1954. Effect to its recommendations was given from time to time, beginning with the Finance Act of 1955.

The third report is of the Indian Tax Reform Commission, 1956 by Professor Kaldor[67]. Professor Kaldor made an investigation of the Indian Tax system in the light of the revenue requirements of the Second Five Year Plan. He studied the Indian tax system thoroughly and gave a number of useful suggestions, which were accepted by the

---

66. Vol.I, p.144 para 2 of the report speaks of the terms of reference in the following words: "The terms of reference require us to examine the tax system in relation to four main aspects; (a) the incidence of the tax system and its suitability for reducing inequalities of income and wealth, viz. the distribution of the burden of taxation and its redistributive effects and possibilities; (b) the suitability of the tax system with reference to the development programme of the country and the resources required for it, including fresh avenues of taxation; (c) the effects of taxation of income of its structure and level-on capital formation and maintenance and development of productive enterprise and (d) the use of taxation in dealing with inflationary and deflationary situations."

67. *Supra* note 3 at p.27. Mr Kaldor, an eminent British economist, was invited by the Indian Statistical Institute in January 1956 to study Indian Taxation and to suggest changes therein.

Government. The report is an outstanding and remarkable achievement, especially considering the short time within which it was accomplished (between January and March, 1956.) As a result of his recommendations income tax on 'capital gains' was revived, three new Acts, vi , the Wealth Tax Act, 27 of 1957, the Expenditure Tax Act, 29 of 1957, (repealed from 1966-67) and the Gift Tax Act, 18 of 1958 were enacted.

Not regarding this as enough the Government decided to revise the whole income tax law. Accordingly, the Law Commission of India was called upon "to revise the Income Tax Act, so as to make its provisions more intelligible, without affecting its basic tax structure." The Commission gave its report to the Government in September, 1958[68]. Its recommendations were implemented by the enactment of the Income Tax Act of 1961.

The fifth report is that of the Direct Taxes Administration Enquiry Committee, 1958[69], commonly known as the 'Tyagi Committee', its chairman being Mr. Mahavir Tyagi. The Committee submitted its report on November 30, 1959. The Committee made a comprehensive study of the law

---

68. <u>Supra</u> note 3 at p.27.

69. The Committe was asked to advise the Government "on the administration, organization and procedures necessary for implementing the integrated scheme of direct taxation with due regard to the need for eliminating tax evasion and avoiding inconvenience to the assessees."

of income tax, its working and pointed out a number of defects in the then existing law and made many suggestions to improve it.

In the light of suggestions and recommendations made by these Committees, a Bill to consolidate and amend the law relating to Income tax and Super tax was introduced in Parliament in the year 1961. The Bill was thoroughly discussed by Parliament and approved in the same year, and it received assent of the President of India on September 9, 1961. Thus, the Income Tax Act, 1961, came into operation with effect from April 1, 1962, repealing the Act of 1922. The Indian Income Tax Act, 1961, is a comprehensive piece of legislation. There are in all twenty-three chapters, incorporating two hundred and ninety-eight sections and six schedules,

It may be noted that in the decade since the enactment of the Income-tax Act, 1961, the Act has been amended several times, beginning on the day following that on which it came into operation, i.e., on April 2, 1962. Within the short span of eight years, from April, 1962 to January 1969, as many as 400 amendments were made to the Act.[70] As a result the provisions of the Act have undergone

70. Administrative Reform Commission:Report on Central Direct Taxes Administration (1969), p.1; L.N. Birla, Welcome Speech, 2nd All India Conference of Tax Executives (1967), Federation of Indian Chamber of Commerce (New Delhi), p.1.

more than 250 insertions, 230 substitutions and 100 omissions[71]. This clearly shows confusion in the minds of the Indian legislatures regarding the policy behind tax legislation. There is no stability in the law and the tax provisions are neither clear nor understandable. The Law Commission has rightly observed in its report that;

> "The amendments to the Income-tax Act have been so short-sighted and so short-lived as to rob the law of that modicum of stability, which is essential to its healthy growth. Before the provisions of the Act can be sufficiently clarified by the judicial process, new provisions are substituted in their place.... Stability is most essential to the proper administration of a taxing statute, and if the tax structure of this country is to be put on a sound footing, it is essential that a halt should be called to the making of ill-digested amendments in a frenzy of hurry, which has characterized the history of income tax law of the last few years."[72]

The amendments to the tax laws, especially Income-tax, which affect a considerable section of the community should not be included in the annual financial Bills, which must be passed in a hurry before a prescribed date. The amendments should be made only after providing adequate opportunities to all the interests concerned to express their views and consulting experts on the proposed change[73].

---

71. '<u>The Law and Practice of Income Tax</u>', J.B. Kanga and N.A. Palkhiwala, Vol.1 (6th ed.), Preface p. ix.

72. <u>Supra</u> note 3, at p.29 quoted from the '<u>12th Report of the Law Commission</u>' Government of India.

73. <u>Supra</u> note 71, at pp. x,xi. Similar views have been expressed by the Administrative Reform Commission (1969), p. (ii), para 6.

Income-tax.

Income-tax, as its name implies, is a tax upon a person in relation to his income[74]. But what is income? The law does not define it. It is strange that the Indian Income-tax Act, 1961[75], the British Income and Corporation Taxes Act, 1970[76] and the corresponding law of other countries, namely, Australia, [77]

---

74. Naranayappa & Brothers v. I.T.O.A.I.R. 1960 Mysore 40, 42; Per Beaumont C.J., in Patiala State Bank v. C.I.T., Bombay A.I.R. 1941 Bom. 93 at p.94. The view was approved by the Privy Council in appeal reported as Patiala State Bank v C.I.T., Bombay A.I.R. 1943 P.C.181. Balaji v. I.T.O., Akola A.I.R. 1962 S.C.: 123.

75. The Income-tax Act, 1961, section 2(24) instead of defining 'Income', states "income" includes (i) profits and gains; (ii) dividends and a number of other receipts as enumerated in clauses (iii) to (viii).

76. The Income and Corporation Taxes Act (1970 Chapter 10) in section 1 states charge of income-tax and not what is meant by 'income'. The section says that:
"Where any Act enacts that income tax shall be charged for any year at any rates, then,...the tax at those rates shall be charged for that year in respect of all property, profits or gains respectively described or comprised in the schedules contained in the following sections of this Act -
Schedule A-Section 67(1), Schedule B-Section 91, Schedule C-Section 93 Schedule D-Section 108, Schedule E-Section 181 (1), and Schedule F-Section 232 (1), ..."

77. The Australian Income Tax and Social Service Contribution Assessment Act 1936-69 is equally vague. The Act merely says in section 6(1) that:
"Income-tax or "tax" means -
(a) income tax and social services contribution imposed as such by any Act, as assessed under this Act".

Canada[78] and America[79] do not attempt to define the term 'income', though in almost all the countries of the world tax on income is levied in one form or another. The justification for the absence of any such definition of the word 'income' from the statute book has been well summarized by the Taxation Enquiry Commission Ceylon (1968) in the following words:

> "The word 'income' is of such elusive import that it cannot be defined in precise terms which would adequately meet legislative requirements. Why its meaning is not to be found in any revenue tax statute is explained by the many shapes which income may assume, and the ultimate variety of circumstances in which it may be derived....There is indeed no concise and complete form of expression which would adequately serve for taxation purposes."[80]

---

78. The Canadian Income Tax Act (RSC 1952 c 148) in section 3 merely states that:
"The income of a taxpayer for a taxation year...is his income for the year from all sources inside or outside Canada and...includes income for the year from all (a) business, (b) property, and (c) offices and employments". Quoted from 'Canadian Income Tax' by Mcdonald (1970), Butterworth, pp. 20,21.
79. Internal Revenue Code 1954 does not say anything about 'income'. The Code merely defines 'Gross Income' and 'taxable income' and leaves the matter to be decided by the Courts. Section 61 states that:
"...gross income means all income from whatever source derived...", and section 63 says that:
"...the term "Taxable income means gross income, minus the deductions allowed..."
80. Report (April, 1968), at p.194, para 67. The statement has been quoted from 'The Principles of Income Taxation', by J.P. Hannan and E. Farnsworth, (Stevens and Sons, 1953); see 'Development of the Concept of Income under the Indian Income Tax Laws (1860-1967)' by O.P. Chawala; (1968) 22 Bulletin for International Documentation, pp. 341-349; see 'Real Income', V.S., (1963) 'lawyer' (Provincial Bar Federation, Madras), pp. 145-148.

The Indian Income Tax Act, 1961, like the income tax laws of other countries, merely sets out provisions that particular kinds of income should be included or excluded when computing the income of a person for the purposes of tax. For instance, clause 24 of section 2 of the Act of 1961 enumerates certain categories of receipts as constituting 'income'[81]. Perhaps the reason for not giving a comprehensive definition to the word 'income' was to keep open the scope of its extension and to leave the matter for judicial decision in any given set of circumstances according to well established principles of law, in the light of needs of the time and change in circumstances. One has to seek guidance from judicial pronouncements, which are based largely on economic usage. The earliest case in which the Privy Council attempted to define the term 'income' is that of C.I.T., Bengal v. Shaw Wallace and Co., in which their Lordships observed that:

> "Income'... connotes a periodical monetary return 'coming in' with some sort of regularity, or expected regularity from definite sources....It is essentially the produce of something, which is often loosely spoken of as 'capital'. But capital, though possibly the source in the case of income from securities, is in most cases hardly more than an element in the process of production."[82].

---

81. See supra f.n. 75

82. A.I.R. 1932 P.C. 138 at p.140.

It may be noted that their Lordships of the Privy Council, while interpreting the scope of the term 'income' in Gopal Saran Narain Singh v. C.I.T., Bihar and Orisa, observed that:

> "the word 'income' is not limited by the words 'profits' and 'gains'. Anything which can properly be described as income, is taxable under the Act unless expressly exempted."[83]

---

83. (1935) 3 I.T.R. 237 at p.242. The question for determination was whether a life annuity, taken in exchange, under an agreement, for an estate, was taxable as income. The Court, while holding that the annuity is taxable, observed that:
"Here the source of the life annuity is a covenant. The life annuity is the produce of one of the items which the appellant has taken in exchange for the estate."
Kamakshya Narain Singh v. C.I.T., Bihar and Orisa, (1943), 11 I.T.R. 513 (P.C.)
The question arose as to whether a payment received by way of royalty under a mining lease, amounts to 'income' for tax purposes or 'capital receipt' (exempt from tax) representing the price of the mines. The Privy Council held that such receipts amount to 'income' taxable under the Income Tax Act. Their Lordships observed that it was not material for tax purposes that the amount received came from a waste property.
Similarly, C.J. Jordan of the Supreme Court of New South Wales in Scott v. Commissioner of Taxation, (1935) 3 A.T.D. 142 at p.144 says:
"The word 'income'... must be determined in accordance with the ordinary concepts and usages of mankind...";
A similar statement can be found in Attorney General of British Columbia v. Ostrum, (1904) A.C., 144,147. The question for determination was regarding the scope of 'income' under the British Columbia Assessment Act, 1897, which imposed a tax on 'all land and personal property and income in the province, subject to certain exemptions, and explained 'personal property' as comprehending 'all income'. Their Lordships observed:"There is no ground for cutting down the plain and ordinary meaning of the word 'income'. In their view the expression was intended to include and does include, all gains and profits derived from personal exertions, whether such gains and profits are fixed or fluctuating, certain or precarious, whatever may be the principle or basis of calculation."

Thus, the courts in India, in their earlier decisions attributed two tests, viz., a source and a quality of periodicity or recurrence in order to name a receipt 'income' for the purposes of income tax. However, in later decisions[84] the courts have not even stressed these tests. For instance, in Rani Amrit Kunwar v. C.I.T., A.P., their Lordships of the Allahabad High Court observed:

> "...[I]ncome in order to be taxable need not arise from any business activity, investment or an enforceable obligation to pay but may arise from voluntary or customary payments. Nor is it necessary that it should be the result of some outlay on the part of the assessee." 85

---

84. Rani Amrit Kunwar v. C.I.T. A.I.R.(1946) All.306 at p. 311 (All)(F.B.), Raghuvanshi Mills Ltd. v. C.I.T., (1952)22 I.T.R. 484. The question for decision was whether a certain amount received by the assessee from an insurance company under a 'consequential loss policy', as a result of the destruction of a mill by fire, was assessable to income tax. It was held that the definition of the word 'income' given in section 2 (6C) of the Income Tax Act, 1922 was inclusive and it included: "certain things which would possibly not be regarded as income but for the special definition. That, however, does not limit the generality of its natural meaning, except as qualified in the section itself."

85. Ibid.

Thus, in short, 'income' may be said to cover all receipts, in the shape of money or money's worth, arising from a definite source and capable of recurring from time to time[86]. As such 'income' may arise from a number of

---

86. Websters' International Dictionary, 1903, at p.745,(Col.2) defines 'income' as follows:
"That gain which proceeds from labour, business, property or capital of any kind, as the produce of a form, the rent of houses, the proceeds of professional business, the profits of commerce or of occupation, or the interest of money or stock in funds, etc.; revenue, receipts; salary; especially the annual receipts of a private person, or corporation, from property." Similarly, the Shorter Oxford English Dictionary, Vol.I (1933) at p.981 defines 'income' in the following terms:
"That which comes in as the periodical produce of one's work, business, lands, or investments (commonly expressed in terms of money); annual or periodical receipts accruing to a person or corporation; revenue."
Robert Murray Haig, an eminent economist, defines 'income' as follows:
"income is the monetary value of the net accretion to economic power between two points of time." Quoted from 'Introduction to Income Tax Law' (Canada) by La Brie, Francis Eugena, (C.C.H. Canadian Ltd.)(1955), p.19.
'Development of the Concept of Income under the Indian Income Tax Law (1860-1967)', by O.P. Chawala: (1968) 22 Bulletin for International Fiscal Documentation, p.341, at pp. 343-344, the author states that:
"Income has been generally described as the annual or periodical yield to a money or reducible to a money value, arising from the use of real or personal property, or from labour or services rendered. Dividends and rents derived from houses and lands are instances of income arising from the use of the property, whilst salaries, wages and professional earnings (including pensions) are instances of income arising from labour or services rendered. Income derived from business may in certain cases be a combination of both these classes.
'The Legal Aspects of Money' by F.A.A. Mann (LL.D. Thesis, London (1938), pp. 1-25 (for concept of income).

sources, viz., salary, wages, dividends, business, interests on securities, capital gains, property, interest on loans and in a thousand other ways. But the legislature have incorporated a number of other kinds of receipts or supposed receipts in the concept of income[87] for the purposes of the Income Tax Act and have extended its scope beyond the ordinary meaning of the term.

Administration of Tax Laws

The Department of Revenue and Expenditure, Ministry of Finance, Government of India, which is in charge of a cabinet minister, is concerned with the financial and economic policy of the government. Thus, all legislations concerning taxes are introduced in the Parliament by the Finance Minister[88], as is done by the Chancellor of the Exchequer in the United Kingdom. As far as the

87. For instance the Income Tax Acts generally include the following receipts as income, though they are not income, strictly speaking:
(1) the rent paid on behalf of a person by his employer, (2) value of rent free house, (3) prerequisites etc.

88. The Finance Minister, in February of each year, submits to both the Houses of Parliament an 'annual financial statement', or 'budget', of the estimated receipts and expenditures of the Government of India for the next financial year, commencing from April, 1, to March 31. The taxing proposals of the budget are embodied in the 'Financial Bill', which establishes the rate of Income-tax for the next financial year, and contains proposed amendment of the tax laws, including changes in rates of customs and excise. In U.K. the financial year runs from April 7 to April 6 of the next year.

implementation and enforcement of direct taxes are concerned, the Central Board of Direct taxes constituted under the Central Board of Revenue Act, 1963[89], is responsible. In brief, the revenue administration may be divided into two parts, viz., one installed at the headquarters and the other in the field.[90]

In the first category, comes the Central Board of Direct Taxes and the Directorate of Inspection located at New Delhi. The Central Board of Direct Taxes consists of five persons including a chairman. The Board performs functions assigned to it by the Central Government or by any other law. The Board frames rules and regulations, issues orders and instructions from time to time regarding assessment and collection of direct taxes to the officers employed in the administration of taxes. The Directorate of Inspection is to assist the Board. Beside this, the Directorate is engaged in many other activities, for instance, research, statistics, vigilance (investigation of alleged misconduct by the employees), training of staff,

---

89. Income-tax Act, 1961, section 116. Formerly, the Central Board of Revenue constituted under the Central Board of Revenue Act (4 of 1924) was responsible for the administration of taxation laws including Income-tax throughout the country.

90. Income-tax Act, 1961, in Chapter 13, sections 116 to 138 prescribes the various categories of Income-tax authorities, their jurisdiction, powers and duties.

audit proceedings, conduct of difficult cases, investigation of major tax evasion cases, in addition to the organizational matters.

In the second category, comes the Commissioner of Income Tax, Inspecting Assistant Commissioners, Income Tax Officers and Inspectors of Income Tax. Thus at the apex of the field structures are the Commissioners of Income Tax. They have been invested with wide powers and authority for the management of all direct tax operations in their respective area. Each Commissioner of Income Tax is assisted by the Inspecting Assistant Commissioners, who exercise the general supervisory control over direct taxes within their jurisdiction. Next in the line come the Income Tax Officers, who are in fact the keystone of the Income tax arch.[91] It is the Income Tax Officer, who is responsible for the assessment of returns, audit of returns and collection of taxes besides a number of other administrative responsibilities. It is the Income Tax Officer who comes in direct contact with the public. In other words, the Income Tax Officer oils the wheels of the tax system and enables it to function smoothly with the

---

91. Administrative Reforms Commission: Report of the Working Group: Central Direct Taxes Administration, Government of India, (1968), para 7.29, pp. 150-151, Report of the Income Tax Investigation Commission, Government of India, (1949), para 381, p. 168.

minimum of friction. The Income-tax Officer is assisted by an Inspector and four clerks in his operations. The administrative set up is illustrated by the chart in Appendix A[92].

The ordinary meaning of the term 'assessment of tax' is the process of valuation of a taxpayer's income for the purposes of taxation. As has been mentioned in the Report of the Diredt Taxes Administration Enquiry Committee:

> "The term 'assessment' refers to the computation of income, wealth, expenditure, gift or estate for tax purposes as well as the determination of the amount of tax payable."[93]

However, the word 'assessment' under the Income-tax Act has been used in a much wider sense. In brief, the assessment covers the entire gamut of proceedings, for ascertaining and imposing liabilities upon the taxpayer, starting from the stage of advance payment of tax, filing of return to the final stage of collection of tax including penalties. In <u>C.I.T., M.P.</u> v. <u>Lady Kanchanbai</u>, Hegde J., while delivering the judgment of the Supreme Court said that:

> "As observed by the Judicial Committee, in <u>C.I.T.,Bom</u>. v. <u>Khem Chand</u>, A.I.R. 1938 P.C. 175, the word 'assessment' is used in the Act as meaning sometimes the computation of income, sometimes

---

92. See Appendix A at p. 533.

93. <u>Supra</u> note 48, para 2.1, at p.5.

> the determination of the amount of tax payable and sometimes the procedure laid down in the Act for imposing liability upon the taxpayer."[94]

There are three main stages in the imposition of taxes, viz., (i) the declaration of liabilities[95], which determines what persons in respect of what property are liable to pay the tax (these provisions are commonly known as the charging sections); (ii) the assessment or determination of the tax payable[96], which quantifies the exact amount of tax, which a person liable has to pay by

---

94. A.I.R. 1970 S.C. 691 at p.693 (para 7) C.A. Abraham v. I.T.O., Kottayam, A.I.R. 1961 S.C. 609 at 611; C.I.T. v. Jahdish Poasad Ramnath (1955) 27 I.T.R. 192, 196-7; Subramariam Chettiar v. Tahsihdar 1963) 47 I.T.R. 759; C.I.T. v. Bhikaji Dadabhai & Co. (1961) 42 I.T.R. 123, 127 (S.C.); Kalawali Devi Harlalka v. C.I.T. (1967) 66 I.T.R. 680 (S.C.) (may include revision); Kunwar Bishwanath Singh v. C.I.T. 1942 I.T.R. 322; Sankappa v. I.T.O. (1968) 68 I.T.R. 760 (S.C.) Kailashnath Bhargava v. C.I.T. (1962) 46 I.T.R. 928; Gurmukh Singh v. C.I.T. 1944 I.T.R. 393, 408. See also Bhailal Amin & Sons Ltd. v. Dalal (1953) 24 I.T.R. 229, City of London I.T. Comrs. v. Gibbs 1942. I.T.R. Suppl. 121, 124 (HL); and Sushil Chandra Ghose v. I.T.O. (1959) 35 I.T.R. 379, 384.

95. Income Tax Act, 1961, sections 4 to 9. It is a well settled rule that one's taxation liability is to be determined according to the provisions of the charging sections and not with reference to the provisions, which deal with the mode of assessment machinery prescribed for its recovery.

96. Income Tax Act, 1961, Chapter 14, sections 139 to 158 deal with procedure for assessment.

way of tax, to the exchequer; (iii) the recovery[97], if the person taxed does not pay voluntarily[98] the Income Tax Officer proceeds to realize tax from the assessee. Thus, the basic features of Income Tax law are the receipt of tax returns, audit, tax computation, collection and realization of taxes. Sub-section (i) of section 139 of the Income Tax Act, 1961, requires every person[99], whether resident in India or not, whose 'total income'[1] during the

---

97. Income Tax Act, 1961, chapter 17, sections 190 to 234 deal with recovery and collection of taxes.
98. In the United States of America the Internal Revenue Service relies primarily upon the disclosure of a taxpayer of the relevant facts in assessing income tax. Gut T. Helvering v. Charles E. Mitchell (1938) 303 U.S. 391-406.
99. The Indian Income Tax Act, 1961, section 2 (31) defines 'person'. It includes:
    (1) an individual,
    (2) a Hindu Undivided family,
    (3) a company,
    (4) a firm.
    (5) an association of persons or a body of individuals, whether incorporated or not,
    (6) a local authority, and
    (7) every artificial juridical person, not falling within any of the preceding sub-clauses.

    A person with no taxable income should file a 'return' to get a refund of the tax, if any, deducted at source from his income and a person who has had a loss in business or profession to have the loss determined for carry forward and set-off against profits in later years.
1. Income Tax Act, 1961, section 2, clause 45 says: "Total Income" means the total amount of income referred in section 5, computed in the manner laid down in this Act. Section 5(i) of the Act states that: "...The total income of a person who is a resident includes all income from whatever source derived..." Kalyanji Vithal Das v C.I.T. (1937), 1 I.T.R. 90,95. Income is divided into 'six heads or categories', viz.,
    1. Income from salaries.
    2. Interest on securities.
    3. Income from property.
    4. Profits and gains from a business, profession or vocation.
    5. Capital gains
    6. Income from other sources.

previous year[2], is taxable[3], to furnish suo motu a 'Return of total Income' in the prescribed form[4] to the Income Tax Officer, generally by June 30[5] of the year of assessment[6].

---

2. Income Tax Act, 1961, section 3 defines 'previous year'. Previous year is generally, the tax payer's accounting year ending on or before March 31, immediately preceding the assessment year. Thus, in the case of a businessman closing the accounts on 31st December, 1966, his 'previous year' for the assessment year 1966-67 is the calendar year 1966; in case of others the 'previous year' is the 'Financial year' immediately preceding the assessment year; see C.I.T. M.P. v. Lady Kanchanbai, A.I.R. 1970 S.C. 691, 693. In C.I.T., Madras, v. Srinivasan and Gopalan (1953) 23 I.T.R, 87, Satyanarayan J, at p.99, explained the term 'previous year' as follows:
"The expression 'previous year' substantially means an accounting year comprised of a full period of twelve months and usually corresponding to a financial year preceding the financial year of assessment. It also means an accounting year comprised of a full period of twelve months adopted by the assessee for maintaining his accounts but different from the financial year and preceding a financial year".

3. Income tax is to be charged on the rate or rates fixed for the specific year by the annual Financial Acts.

4. The Income-tax Rules, 1962, Section 12, prescribes three types of forms of 'returns', viz., (1) Form no.1 (green) for companies; (2) Form no.2 (pink) for persons other than companies; (3) Form no.3 (white) to be used alternative to Form no.2 for taxpayers (other than companies, cooperative societies and local authorities) whose (i) total income does not exceed Rs. 15,000, or (ii) who have no income under the head 'profits and gains of business or profession'.

5. The Income Tax Officer is authorized by the proviso to Section 139 (1) of the Income Tax Act, 1961 to extend the time for furnishing the 'return' in deserving cases on an application being made to him U/S 139 (1)(1), (11) (111)

6. Income Tax Act, 1961, section 2 clause 9 says that: "Assessment year" means the period of twelve months commencing on the 1st day of April every year." A taxpayer closing the accounts of his business or profession after the 31st December of the year immediately preceding the assessment year should make the return of his income within six months from the date on which the accounts were closed.

Further sub-section (2) of section 139 of the Act authorizes the Income-tax Officer to serve notices on those persons whose total income rendered them liable to income-tax in his opinion, to furnish a return of income within a specified period and in the prescribed manner. On failure to furnish a return, without reasonable cause, an assessee renders himself liable to 'best judgment assessment', under section 144, and refusal to grant registration or cancellation of the registration of firms under sections 185(5) and 186(2) of the Act in addition to penalty and prosecution under sections271(1) and 276(b) in appropriate cases[7].

The general procedure after the return is filled i s that the Income-tax Officer scrutinizes it, and, if he is satisfied that it is correct and complete, he will send the assessee a 'Notice of Demand' and specify the tax due and the date of payment.[8] In case the Income Tax

---

7. Supra note 71, pp. 704,705.

8. As a rule the income-tax in the normal course can only be levied after the completion of the assessee's financial year. Sometimes, it happens that by the time the regular assessment under section 143 is completed, the assessee has spent his income, or has left the country, and disposed of his assets to avoid payment of taxes. In such cases provision has been made for assessment of income during the current Financial year under sections 174, 175 and 176, in order to protect the interest of revenue, the Income Tax Act has made provision for the collection of tax at various stages, viz.,
   1. the regular assessment including representative assessment (sections 143 to 149);
   2. deduction of tax at source (sections 192 to 206);
   3. provisional assessment (section 141);
   4. advance payment of tax (sections 207 to 219).

Officer wants further information or evidence, he sends a notice, either under section 142(1) or 143(2) of the Income Tax Act, 1961, as the case may be to the assessee to furnish such information or evidence by an appointed date. This notice calls upon the assessee to attend or to produce or cause to be produced any evidence on which he may rely to establish the correctness of his 'Return'[9]. Thereafter the Income Tax Officer goes through the information furnished and, if he is still not satisfied he may ask the assessee to furnish further details[10].

---

9. The assessee need not attend the office personally unless called for under section 131. He may depute any one of the following on his behalf, viz.:
   1. a relative;
   2. a person in his employment;
   3. a lawyer;
   4. an accountant;
   5. an income-tax Practitioner and
   6. an officer of a scheduled bank with which the assessee has regular dealings.

10. The following are in short the various stages of assessment: (i) Submission of return of income by the assessee, (ii) issue of notice under section 142(i) and 143(2), (iii) determination of taxable income, (iv) service of the notice of demand. Income Tax Act, 1961, section 131 , has given wide power to Income Tax Officer.

Thus, after examining the relevant documents, evidence produced by the assessee and after taking into account the result of any other enquiries he might have made, he would determine the 'total income' and tax payable. He would then send a 'Demand Notice' for the tax due, accompanied by a copy of assessment order and a chalan.

Section 144 like section 23(4) of Income Tax Act, 1922, empowers the Income-tax Officer to make the assessment to the best of his judgment[11] in the following three cases, viz., where a person -

"(a) fails to make the return required by any notice given under sub-section (2) of section 139[12] and has not made a return or a revised return under sub-section (4)[13] or sub-section (5)[14] of that section, or

---

11. Taxes Management Act (1970, Chapter 9) section 29(1)(b) provides provision for 'best judgement assessment'. See 'The Best Judgement Assessment undef the Indian Sales Tax Law', by S.N. Jain (1965) 7, Journal of I.L.I. p.82; 'British Tax Encyclopedia, by G.S.A. Wheatcroft, Vol.1, para.1-1414, p.1696. C.I.T., Burma v. Messrs. Ein Stin (1947) 15 I.T.R. 290, I.T.C. v. Beharilal I.L.R.1942 All 452 at p.114.

12. Supra pp. 47-49 For section 139(2).

13. Income Tax Act, 1961, section 139(4) provides that if a return is not furnished within the time, the return may be furnished at any time before the assessment is made. However, the person will be liable to penalty, if the failure was without any reasonable cause.

14. Income Tax Act, 1961, section 139(5) empowers a person who has furnished a return to rectify any omission or wrong statement before the completion of assessment.

(b) fails to comply with all the terms of a notice issued under sub-section (1) of section 141[15], or

(c) having made a return, fails to comply with all the terms of a notice issued under sub-section (2) of section 143, ..."[16]

However, and assessee can apply to the Income Tax Officer for cancellation of the best judgement assessment and to make a fresh assessment under section 146[17] of the Act of 1961, if he was prevented by sufficient or reasonable cause to comply with the statutory requirements under the Act[18]. And the Income Tax Officer is bound to

---

15. See <u>supra</u> p.50 for section 142(1).
16. See <u>supra</u> p.50 for section 143(2)
17. A best judgement assessment can be cancelled on the following grounds, under section 146 of the Act of 1961, viz., -

    "(i) that the assessee was prevented by sufficient cause from making the return required under sub-section (2) of section 139, or
    (ii) that he did not receive the notice issued under sub-section (1) of section 142 or sub-section (2) of section 143, or
    (iii) that the assessee had not had a reasonable opportunity to comply, or was prevented by sufficient cause from complying with the terms of any notice referred to in clause (ii)..."

18. <u>C.I.T.</u> v. <u>Dhanmal Chellaram</u>, (1948 I.T.R. 319,322; Abdul Baree Choudhary v. C.I.T., 5 I.T.C. 352, 358-59

cancel the assessment if he is so satisfied. It may be noted that the Income-tax Officer must act in a judicious way and should not exercise his power in a vindictive manner with a desire to punish. As said by Hegde J, in State of Orisa v.Maharaja Shri B.P. Singh:

> "The power to levy assessment on the basis of best judgement is not an arbitrary power; it is an assessment on the basis of best judgement. In other words that assessment must be based on some relevant material. It is not a power that can be exercised under the sweet will and pleasure of the concerned authorities."[19]

In a recent case from British Guiana Argosy Co. Ltd. v. I.R.C.[20], the Judicial Committee of the Privy Council held that in the absence of materials necessary for forming an opinion regarding an assessee's income for the relevant year, the best judgement assessment could not be made.

---

19. A.I.R. 1970 S.C. 670, at p. 671 (para 4); The Privy Council in C.I.T. v. Laksmi Narain Badridas (1937) 5 I.T.R. 170, at p. 180, in a very lucid language has analysed the facts which an Income-tax Officer should take into consideration in making a 'best judgement assessment.' The Court said that:
"The Officer ... must make what he honestly believes to be a fair estimate of the proper figure of assessment, and for this purpose he must ... be able to take into consideration local knowledge and repute in regard to the assessee's circumstances, and his own knowledge of previous returns by and assessments of the assessee and all other matters which he thinks will assist him in arriving at a fair and proper estimates".
Raja Puttaiah v. Dy. Commercial Tax Officer, Kurnool A.I.R. 1970 A.P. 125,126; amini Bus Company Ltd. v. C.I.T., Colombo, 1952 A.C. 571 (P.C.); Govindram Saksaria v. C.I.T. (Central Bombay) A.I.R. 1943 Bom. 122; I.T.C. v. Badridas Ramrai Shop Akola, I.L.R. 1941 Nag. 360.

20. (1971) 1 W.L.R. 514 (P.C.).

In this case the taxpayer company failed to submit an income-tax return for the year of assessment 1962, because all the books of the company were destroyed by a fire in a riot in February, 1962. The company had incurred trading losses in the two previous years and had to carry forward in the assessment year a loss of $62,344. The Commissioner of Inland Revenue rejected the appellant's claim and made a best judgement assessment of $25,000 under section 48(4)[21] of the Income Tax Ordinance, 1953.

Their Lordships rejected the Commissioner's claim and held that the right of the Commissioner to make an estimated assessment never arose under section 48(4), because on the facts of the case, he could have formed no reasonable opinion that the company was liable to income-tax for the assessment year in question, owing to large loss carried forward which would have to be set against its chargeable income.

---

21. Sub-section (4) of section 48 provides that: " Where a person has not delivered a return and the Commissioner is of the opinion that the person is liable to pay tax, he may, according to the best judgement, determine the amount of chargeable income for that person and assess him accordingly..."

The important question that arises in this connection is that what is the meaning and scope of the phrase 'sufficient or reasonable cause', that may justify cancellation of a best judgement assessment and call for a fresh assessment in accordance with the provisions of section 143[22], or section 144[23]. It is surprising that the terms 'sufficient' or 'reasonable cause' have not been defined by the legislature anywhere, and the judiciary, too, has not attempted to do so. Every case is to be judged and decided according to its own facts and circumstances. In other words, the question whether a particular cause, that operated on the mind of the assessee and prevented him from complying with the statutory requirements of notice as provided by section 144, which led to the best judgement assessment was sufficient to justify its non-performance or not, is a question of

---

22. Income Tax Act, 1961, section 143 lays down the procedure for assessment which the Income-tax Officer should follow.

23. See <u>supra</u> pp.51,52 for text of section 144.

fact[24]. Some of the cases which throw light on the point will now be discussed.

In Lachman Prasad v. Commissioner of Income-tax, U.P.,[25] the respondent failed to produce the accounts of a branch before the local Income-tax Officer, as required under section 23(2) of the Income Tax Act, 1922, but promised to produce it before the Income-tax Officer assessing the head office. He did not produce the account at the head office on the pretext that it was inconvenient to produce the branch accounts at the head office. It was held that the Income-tax Officer was justified in making a best judgement assessment and that the assessee was not prevented by sufficient cause from producing the accounts before the Income-tax Officer under section 27 of the Income-tax Act, 1922[26]. The Court observed that the question

---

24. C.I.T. v. Laxminarain Badridas, (1937) 5 I.T.R. 170, 179 (P.C) Abdul Baree Choudhary v. C.I.T. 5 I.T.C. 352,358 (F.B.); A.I.R. 1931 Ran 194; Chinaranjni Lal Govinda Prasad v. C.I.T.,5 I.T.C. 28; Nannesh Mal Jank Das v. C.I.T. 1941 I.T.R. 333; A.I.R. 1934 Lah 983; In re Keshardeo Chamria (1935) I.T.R. 418; Vithal v. C.I.T. (1938) I.T.R. 264. Chaturbhuj v. C.I.T. A.I.R. 1941 Oudh 445; Sheoduttrai Pannalal v. C.I.T. A.I.R. 1940 All. 530; Manbhum Transport Co. Ltd. v. C.I.T. 6 I.T.C. 203; Ram Kaur Mohan Lal v. C.I.T 3 I.T.C. 375.

25. A.I.R. 1925 All 385.

26. Sec. 146 of the Act of 1961 is the corresponding section.

is one of fact and the Income-tax Officer's decision is final on the point. While explaining the meaning of the word 'prevent', the Court said that:

> "The word 'prevent'...involves some definite active cause, making compliance with the order impossible, and not a passive cause such as the opinion that compliance is not obligatory because of the rights supposed to be secured under the Act."[27]

In Lalit Kishore Mitra v. C.I.T., Bihar,[28] the petitioner failed to submit a return in accordance with a notice under section 22(2)[29] of the Income-tax Act, 1922, and his assessment was made summarily under section 23(4)[30] of the Act. He filed an application to the Income-tax Officer under section 27 for the cancellation of the assessment on the ground that the petitioner's son, who was entrusted with the responsibility of preparing the return forgot to do so, due to his preoccupation with the arrangements of the petitioner's grand-daughter's wedding.

---

27. A.I.R. 1925 All. 385 at p.387.

28. A.I.R. 1932 Pat.166. See supra pp. 51-52.

29. Corresponds to section 139(2).

30. Corresponds to section 144.

The application was rejected, the reason being inadequate. When the petitioner moved the Court, it rejected the petitioner's application and held that the question of sufficiency or insufficiency was not a matter of law.

In Banarsi Das v. C.I.T. Punjab, N.W.F., Delhi and Lahore,[31] the Lahore High Court rejected the petitioner's application under section 66(3)[32] of the Income-tax Act, 1922, for a mandamus to compel the Commissioner of Income-tax, Punjab, to state the case of the petitioner and the point of law arising therein to the court.

The petitioner, a mill owner, submitted a return for the assessment year 1932-33 declaring a gross income of Rs. 25,636, against which Rs. 76,885 was set on account of depreciation. The Income-tax Officer, being dissatisfied with the return, issued a notice under section 22(4) calling upon the assessee to produce complete account books. The assessee produced some but failed to produce the rest, in spite of a long extensiom of time. The Income-tax Officer

---

31. A.I.R. 1936 Lahore 489.

32. I.T.A., 1922, section 66(3) stated cases in which the High Court might require the Tribunal to treat an application within time where the Tribunal in reply decided that the application to refer any question of law to the High Court was time barred.

proceeded to assess the income under section 23(4) of the Act of 1922, to the best of his judgement, and the assessment was completed on September 8, 1933. The petitioner filed an application to the Income-tax Officer under section 27 for the cancellation of this assessment which was rejected. Dismissing his subsequent petition to the Court, Abdul Rashid, J.,said:

> "... It was possible for the Income-tax Officer to find as a [sic] fact that the assessee had failed to establish 'sufficient cause' or 'not reasonable opportunity' within the meaning of this Act."[33]

Similar view has been taken by the Rangoon High Court in Abdul Baree Choudhary v. C.I.T.[34], the Madras High Court in Siva Pratap Bhatiadu v. C.I.T.[35]. The Privy Council in C.I.T. v. Laxminarain Badri Das,[36] held that it was not possible to turn the question of fact into a question of law, by asking whether, as a matter of law,

---

33. A.I.R. 1936 Lahore 489 at pp. 491, 492.

34. A.I.R. 1931 Ran. 194.

35. I.T.C., 323.

36. 1937 I.T.R. 170 (P.C.).

the Income-tax Officer arrived at a correct conclusion upon a matter of fact. However, in certain cases where the illegality of the notice or shortness of time is pleaded as sufficient cause for non-compliance with notice, or lack of reasonable opportunity is urged, it may involve a question of law[37].

For instance in re Messrs. Sadaram Puranchamd,[38] the assessee, an unregistered firm, did not file a return for the assessment year 1929-30, in pursuance of an Income-tax Officer's notice under section 22(2) of 26th July, 1930, and so he was treated as in default since 25th October, 1929. On 15th November, the Income-tax Officer issued a notice under section 22(4) requiring the assessee to produce the books of accounts on 16th December, when the assessee submitted a return showing an income of Rs. 18,000.

The Income-tax Officer, being dissatisfied with the return issued another notice under section 22(4) and 23(2) on 16th December to produce evidence and accounts of the Head Office and of all the branches by the 19th December 1929.

It was held that there was no doubt that the assessed was in default in submitting the return since October 24, but the return submitted on 16th December was

---

37. Supra n.71 at p.768.

38. A.I.R. 1931 Cal. 729.

a valid return within section 22(3), as it was made before the assessment was completed. Before such a return could be disregarded, the assessee was entitled to a reasonable opportunity to produce any evidence upon which he might rely in support of the return. As regards the question whether a notice issued on 16th December requiring the assessee to comply with its provisions on the 19th December is a reasonable notice. Rankin, C.J., said,

> "Whether a given time is a reasonable time is no doubt a question of fact; but on the border line the question arises whether the time is not so short that it cannot be reasonable....I am prepared to hold as a matter of law that he did not give to the assessee such reasonable opportunity as the Act requires to produce their evidence in support of their return."[39]

Similarly, in Moha Ishaq v. Commissioner of Income-tax,[40] the Punjab High Court held that the question whether an assessee was given a reasonable opportunity to produce evidence in support of the return and whether the time given was so short as not to be reasonable are questions of law for reference to the High Court.

Another case on the point is Sachchidananda Sinha v. Commissioner of Income-tax[41], in which the Court held

---

39. Ibid at p.731.

40. A.I.R. 1954 Punjab 296.

41. A.I.R. 1924 Patna 644.

that the sufficient notice should be given to an assessee when an order is passed against him under section 33 of the Act of 1922[42], by the Commissioner of Income Tax while exercising the power of an Income Tax Officer under section 23(2). The petitioner was assessed on the 25th May, 1923. Subsequently, it was ascertained that the assessee owned certain house property at different places. The Commissioner of Income Tax issued a notice under section 33 of the Act of 1922, on December 13, 1923, to the assessee to show cause within a week's time as to why a sum of Rs. 2,400/-, the annual letting value of a house at Allahabad, should not be included in his return for the purposes of assessment. A supplementary demand was issued by the Income Tax Officer,on the assessee's failure to explain. The Court held that the assessee was not given a reasonable opportunity and that one week's notice was not reasonable under the circumstances.

In Smt. Rajmani Devi v. C.I.T.[43] it was held that the

---

42. Income Tax Act, 1922, section 33 originally dealt with the power of revision by the Commissioner. The section was replaced by another section in 1941, with the setting up of the Appellate Tribunal and provided for appeals against order of the Appellate Assistant Commissioner. The present Income Tax Act, 1961, has similar provisions in sections 253,254, 267.
43. A.I.R. 1937 All. 770; in re Radhey Lai Bal Mukund 1942 I.T.R. 631; C.I.T. v. Ekbal and Company, A.I.R. 1945 Bom. 34.

illegality of a notice under section 23(2) is a good ground for non-compliance with its provisions. Their Lordships held that where the Income-tax Officer, bound to issue a valid notice under section 23(2), issued a notice which was invalid, it must be deemed that no notice under section 23(2) was issued to the assessee and to that extent the Income-tax Officer was in default. It was further stated that the assessee, in default in having failed to comply with the terms of a notice under section 22(4), could very well say that as the imperative notice under section 23(2) was not issued to him, he could ignore the notice issued under section 23(4) and in that sense he was prevented from complying with this notice.[44]

In re Kajori Mal Kalyan Mal[45], the Allahabad High Court ruled that the question whether an assessee was prevented by sufficient cause from complying with the notices issued by the Income-tax Officer is a mixed question of fact and law. The Income-tax Officer issued a notice on 13th April, 1928, under section 22(2) calling on the Karta (manager) of a joint Hindu family to submit a return of income by 12th May, 1928. As the assessee did not appear on the fixed date, the Income-tax Officer issued another notice under section 22(4), to submit his account books on 28th May, 1928, which too was ignored by

---

44. Ibid at p.778.

45. A.I.R. 1930 All. 209.

the assessee, on the pretext of his son's wife's illness and his own toothache. Thereafter the Income-tax Officer made an assessment under section 23(4) of the Act to the best of his judgement. The question of law that arose in the case was whether the notice that was issued to the petitioner was a legal notice. It was held that the notice was not a legal notice, because the assessee was not given the minimum prescribed period of 30 days' within which to file the return. The notice provided 29 days only and so there was sufficient cause for non-compliance with its provisions.

The Income Tax Act, 1961, like the Act of 1922[46] has made provision for assessment of income, which escaped assessment at the time of the regular assessments in the relevant years[47], owing to a taxpayer not fully disclosing his income[48]. Section 147 of the Act empowers an Income-tax Officer to unearth undisclosed income and to assess it in order to make good to the State any loss of tax[49]. And in cases of concealment of income penalty proceedings may also

---

46. Income-tax Act, 1922, section 34 provided for assessment of income escaping assessment. The present sections 147 to 153 have taken the place of section 34 of Act of 1922.

47. Supra n.71.

48. 'British Tax Encyclopedia', G.S.A. Wheatcroft, Vol.I, para 1-1432, p.1705.

49. In United Kingdom, British Tax Management Act, 1970, sections 36,37,39 provide for assessment of tax lost to the Government owing to fraud or wilful default or neglect of any person.

be launched under section 271(1)(c) of the Act[50]. Sections 148 to 153 lay down the procedure to be adopted in such cases. Section 147 provides that:

> "If-
> (a) the Income-tax Officer has reason to believe that, by reason of the omission or failure on the part of an assessee to make a return under section 139 for any assessment year to the Income-tax Officer or to disclose fully and truly all material facts necessary for his assessment for that year, income chargeable to tax has escaped assessment for that year, or
> (b)... the Income Tax Officer has, in consequence of information in his possession, reason to believe that income chargeable to tax has escaped assessment... he may,..., assess or reassess such income or recompute the loss or the depreciation allowance, as the case may be, for the assessment year concerned..."

Thus the section does not give unfettered jurisdiction to an Income-tax Officer to initiate proceedings for assessment of escaped income. The Income-tax Officer can exercise his jurisdiction under section 147, only if conditions laid down in clauses (a) and (b)

---

50. See *infra* pp.286,287 for section 271 (1) (c).

are fulfilled[51]. For instance to initiate proceedings under clause (a):

(i) the Income-tax Officer must have ' reason to believe'[52] that income has escaped assessment; and

(ii) income must have 'escaped assessment' by reason of the omission or failure on the part of the assessee

---

51. T.S. Chettyar Firm v. C.I.T. A.I.R. 1931 Raj. 333. the Income-tax Officer is empowered to assess only the income, profits or gains of a person chargeable to income tax, that have escaped income. He is not required to examine de novo the whole assessable income of such assessee. Section 148 provides for notice to be issued before initiation of proceedings for assessment under section 147 and section 149 prescribes a period of limitation.

52. 'Reason to believe' has been interpreted by the Courts to mean that the belief must be that of an honest and reasonable man based upon reasonable grounds. Mere suspicion is not enough to take action under section 147. See Bhimraj Pannalal v. C.I.T. (1957) 32 I.T.R. 289,304, affirmed (1961) 41 I.T.R. 221 (S.C.); Lakshman Shenoy v. I.T.O. and I.T.O. v. City Tobacco Mart (1958) 34 I.T.R. 275, 288 (S.C.); Mahabir Prasad Munna Lal v. C.I.T. 1947 I.T.R. 393, 402-3; Haji Ahmed Eshak & Co. v. C.I.T. (1951) 19 I.T.R. 391; Narayanappa v. C.I.T., (1967) 63 I.T.R. 219 (S.C.). Income-tax Officer must give reason for rejecting accounts submitted by assessee for making assessment of escaped income. C.I.T. Calcutta v. Pudamchand Ramgopal (1970) I S.C.W.R.740.

(a) to make a return of his income under section 139[53], or

(b) to disclose fully and truly all material facts[54] necessary for the assessment, and

under clause (b)

(iii) the Income-tax Officer must have "in consequence of information[55] in his possession reason to believe" that income has escaped assessment.[56]

---

53. Pannalal Nandlal Bhandari v. C.I.T. (1961), 41 I.T.R. 76(S.C.); Md. Bashir v. I.T.O.(1962) 46 I.T.R. 827.

54. 'Material fact' means primary facts-the duty of the assessee is only to disclose the primary facts; and he is not required to indicate what factual or legal inferences should be drawn from the primary facts. See Calcutta Discount Co. Ltd.,v. I.T.O. A.I.R. 1961 S.C. 372; Rameshwar Goenka v. I.T.O., A 'Ward' Shillong A.I.R. 1970 Assam 84; 85; M/S Munilal Randayal v. I.T.O. Buripada A.I.R. 1970 Orisa 58; Muthiah Chettiar v. C.I.T. Madras. A.I.R. 1970 S.C. 10; P.R. Mukerjee v. C.I.T. W.B. A.I.R. 1956 Cal. 197. C.I.T.,Gujarat v. Messrs. Bhonji Lavji Porbondar A.I.R. 1971 N.S.C. 91 at p.42. Mere production of account books or other evidence does not necessarily amount to disclosure, C.I.T. Calcutta v. Burcop Dealers A.I.R. 1971 S.C.N., S.C. 100 at p.45.

55. "Information"has been defined by Shah J., in C.I.T. v. Raman & Company, (A.I.R. 1968 S.C. 49, p.51), as, "...Instruction or knowledge derived from an external source concerning facts or particulars, or as to law relating to a matter bearing on the assessment. If as a result of information in his possession the Income-tax Officer has reason to believe that income chargeable to tax had escaped assessment, the Income-tax Officer has jurisdiction to assess or reassess the income..." See V. Jaganmohan Rao v. C.I.T. & E.P.T. A.I.R. 1970 S.C. 300.

56. Supra n.71 pp.775,777. I.T.O., Mangalore v. N. Damedar Bhat A.I.R. 1969 S.C. 408.

Collection and Recovery of Taxes

The Income Tax Act, 1961, provides provisions for collection and recovery of taxes in chapter 17, in sections 190 to 234[57]. The Act of 1961,(like the earlier Act of 1922) provides two modes of collection of taxes, viz., collection of tax at source and direct payment of taxes[58]. If the tax demanded is not paid within the time specified in the notice of demand under section 156[59] or extended time[60], the assessee has to pay simple interest at nine per cent[61], per annum for the period of default and the assessee shall be deemed to be in default[62]. In addition to interest a defaulting assessee renders himself liable to a fine under section 221[63].

The Income-tax Officer, where an assessee is in default or is deemed to be in default in respect of making a payment of tax[64], advance tax[65], interest, fine, penalty or any other sum payable under the Act[66], will send a

57. Similar provisions were contained in the Income-tax Act, 1922, in chapter 6, sections 45 to 50.

58. See Chapter VI , pp.264-66.

59. Income-tax Act, 1961, section 220(1) places the limit of 'thirty-five days of the service of the notice'.

60. Income-tax Act, 1961, section 220(3) gives power to the Income Tax Officer to extend the period for a payment or allow payment by instalment.

61. Income-tax Act, 1961, section 220(1).

62. Income-tax Act, 1961, section 220(4).

63. See Chapter VI , pp. 334-36. Purshatton Gouindji v. B.M. Desai A.I.R. 1956 S.C. 20,25 (para.14).

64. Income-tax Act, 1961, sections 220(4),226(3)(x).

65. Income-tax Act,1961, section 218.

66. Income-tax Act,1961, section 229.

certificate to the Tax Recovery Officer[67] specifying the amount of arrears due from the assessee within one year from the last date of the finance year in which the demand was made[68]. The Tax Recovery Officer, on receipt of such certificate, shall proceed to recover from such assessee the amount specified therein by one or more of the modes mentioned below; such as:

(a) attachment and sale of the assessee's movable property;

(b) attachment and sale of the assessee's immovable property;

(c) arrest of the assessee and his detention in prison[69];

(d) appointing a receiver for the management of the assessee's movable and immovable properties.[70]

---

67. Income-tax Act, section 2(44) states that 'Tax Recovery Officer' means-
(i) a Collector or an additional Collector;
(ii) any such officer empowered ... to exercise the powers of a Tax Recovery Officer;
(iii) any Gazetted Officer of the Central or a State Government who may be authorized ... to exercise the powers of a Tax Recovery Officer."

68. Income-tax Act, 1961, section 231.

69. <u>Collector of Malabar</u> v. <u>Erimmal Ebrahim Hajee</u> A.I.R. 1957 S.C. 688.

70. Income-tax Act, 1961, section 226 provides other modes of recovery, viz., deduction from salary, collection from persons who owe money to assessee, application to Court for payment of money in Court's custody; section 227 provides procedure for recovery through State Government and section 232 provides for recovery by suit.

The present provision relating to recovery and collection of taxes is an improvement over its analogous provisions contained in section 46(2) and Explanation clause attached to section 46(7) of the Act of 1922. The former provides a self-contained code for the recovery of tax and other sums payable under the Act[71], whereas the latter provided for recovery of tax by proceedings under the State laws (which vary from State to State) for recovery of land revenue[72] and the exercise of the powers of a civil court in those proceedings. The provisions under the Act of 1961 are more appropriate for the recovery and collection of taxes, because they are self-contained and lay down the procedure to be adopted in such cases. The Department is not to seek resort to some other agency as in case of the earlier Act, i.e. machinery for the recovery of land revenues in respective States of the Union.[73]

---

71. The Law and Practice of Income Tax, J.B. Kanga and N.A. Palkhiwala, Vol.1 (6th ed.) p.936.
72. Land Revenue is a tax on agricultural land. It is an item covered by Entry 45 of List II, of VIIth Schedule of the Constitution of India. Tax is assessed and collected by the proprietor of an estate or tenure according to the Land Revenue Act of the respective State under whose jurisdiction particular land falls. See Bageshwari v. Gowhar I.L.R. 31 Cal. 256 (P.C.); Jairam Sahu v. Emperor A.I.R. 1923 Pat 358.
73. Purshottam Govindji Halai v. B.M. Descis A.I.R. 1956, S.C. 20,25.

Appeal and Revision.

An assessee has the right of appeal[74] and revision[75] if he has a grievance against the assessment order, the imposition of fine, the initiation of a prosecution and the issue of any other statutory order by the Income-tax authorities[76]. The assessee can appeal to the Appellate Assistant Commissioner against any order of the Income-tax Officer[77]. The appeal must be filed in a prescribed form within a period of 30 days of the receipt of the order[78]. The Appellate Assistant Commissioner, after hearing the appellant and the Income-tax authorities, will pass his order and send copies to both parties. The assessee can further go in appeal to the Income-tax Appellate Tribunal[79]

---

74. Income-tax Act, 1961, sections 246 to 255,261,262.

75. Income-tax Act, 1961, sections 263,264.

76. Income-tax Act, 1961, 246 to 269 deal with the provisions of appeal and review extensively.

77. Income-tax Officer will pass order under section 246, 247 and 248.

78. Income-tax Act, 1961, section 246.

79. The Tribunal is a high powered body with an equal number of judicial members and accountant members, one of whom is appointed President of the Tribunal. The Tribunal is a quasi-judicial body, independent of the Board of Direct Taxes and is under the adminstrative control of the Ministry of Law. The Tribunal functions through various Benches, each ordinarily consisting of a judicial and an accountant member. At present there are 11 Benches working in the whole of India: Income Tax for the Layman: The Directorate of Inspection, Research, Statistics and Publication, New Delhi (6th ed.) 1966 at p.82.

against the order of the Appellate Assistant Commissioner[80] or Inspecting Assistant Commissioner[81] or Commissioner[82] within 60 days of the receipt of the order. The Income Tax Department may also prefer an appeal against the order of the Appellate Assistant Commissioner.

The Tribunal, after hearing the appellants and respondants, will pass its order and communicate the same to both the parties. The decision of the Tribunal is final, in so far as a question of fact is concerned and is not appellable. However, reference may be made to the High Court[83] and on appeal to the Supreme Court[84] of India on an important question of law involved in the case, which needs interpretation. The aggrieved party may, within 60 days of the receipt of the Tribunal's order, file an application to the Tribunal to make a reference under section 256 (i) of the Income Tax Act, 1961 to the High Court of their respective State. If the Tribunal refused to do so, the interested party might move the High Court under section 256 of the Act to direct the Tribunal to state the facts and submit the case for decision. The High Court may, if

80. Income-tax Act, 1961, sections 131,250 or 271.
81. Income-tax Act, 1961, section 274 (2)
82, Income-tax Act, 1961, section 263.
83. Income-tax Act, 1961, section 256 (Reference to the High Court).
84. Income Tax Act, 1961, section 261.

it thinks proper, direct the Tribunal to send the case and will decide the question in dispute. The judgement of the High Court is final, unless an appeal is preferred before the Supreme Court of India[85], after obtaining leave to appeal from the High Court concerned or, on its refusal, by the Supreme Court itself. The Income Tax Appellate Tribunal may also refer a case to the Supreme Court directly[86], if it considers this appropriate, in view of the conflicting decisions of the High Courts on the point in question.

The Income-tax Act, 1961[87] has also prescribed an alternative remedy to an appeal by an aggrieved party against the orders of the Income-tax Officer, or the Appellate Assistant Commissioner by way of revision. If an assessee so desires, he can appeal to the Commissioner of Income Tax, on paying the prescribed fee, against such orders[88]. The Commissioner may also, on his own initiative, call for and examine the record of any case and pass appropriate orders[89]. However, if the assessee chooses this course of action, he cannot appeal to the Assistant Commissioner or the Tribunal[90].

---

85. Ibid.
86. Income Tax Act, 1961, Section 257.
87. Income Tax Act, 1961, sections 263, 264.
88. Income Tax Act, 1961, section 264 (3).
89. Income Tax Act, 1961, section 263.
90. Income Tax Act, 1961, section 264,

CHAPTER III

TAX-AVOIDANCE

The Nature of 'Tax-Avoidance'

Though it is difficult to define 'tax-avoidance',[1] it may be explained, as stated earlier[2], as an arrangement by which a person, acting within the framework of the law, reduces his true tax liability[3] with the help of artificial schemes, devices, transactions and manoeuvres to pay less to the Exchequer than what he would have paid but for the arrangement. It is nothing but the art of dodging payment of revenue without actually breaking the law[4]. For

---

1. Lord Denning in Grifith (Inspector of Taxes) v. J.P. Harrison, (1963) A.C.I (H.L.)=(1962) 2 W.L.R. 609, while giving a dissenting judgement defined the word 'trade' in the following words. This definition applies equally to the case of 'avoidance'. He states: "...The word "trade" is one of those common English words which do not lend themselves readily to definition but which we all of us think understand well enough. We can recognize a "trade" when we see it... But we are hard pressed to define it" (1962) 2 W.L.R. 609, 620. See chapter 4, infra p. 143 for details of the case.
2. See Chapter I for definition of tax avoidance.
3. 'Report of the Direct Taxes Administration Committee, 1958-59', Government of India, para 7.3, p.147; 'The Problem of Personal Income Tax Avoidance; Harry J. Rudick, (1940) 7, Law and Contemporary Problems, 243, 254 (Duke University Publication); 'An Ounce of Prevention: A Study in Corporate Tax Avoidance' by H.A. Freeman and L.H. Kirshner (1946) 46 Col. L.R. 951, 953. Tax avoidance has been defined as the "escape from or the reduction of taxes by legally permissible means".
4. "Attitude of the Legislature and Courts to Tax Avoidance by G.S.A. Wheatcroft (1955) 18 Mod. L.R., p 209.

example, when a person adopts one of the several possible courses open to him, because it would save him most in taxes, without any reasonable cause and excuse, the purpose of the transaction is obvious, i.e., to avoid his true tax liability. Such an act is, in legal terminology, 'tax avoidance'.

One of the most common devices adopted for avoiding taxes is that of transferring or dividing one's assets, holdings or income between one's nominees and thus splitting income into smaller units. In this way the assets transferred are taxed individually at a lower rate-income tax being assessed at a lower rate in the lower income groups as compared with higher income groups[5].

An interesting device of reducing taxes is found in the case of re Central Talkies, Circuit, Matunga[6]. The case shows how an ingenous taxpayer can outwit the provisions of the law without breaking it. The assessees were a firm carrying on business in partnership in the name of Central Talkies Circuit, Matunga in Bombay. The firm consisted of husband, wife and their minor children. In April, 1937, section 16(3)[7] of the Income Tax Act, 1922,

---

5. '<u>Tax Avoidance in India</u>' by R.K. Dalal, (1953), 7, Bulletin for international Fiscal Documentation, p.1.
6. A.I.R. 1941 Bom. 205.
7. See Chapter 4, p.179 for the text of section 16(3).

was amended, so that the share of a wife or a minor son in partnership in a business had to be included in the income of an assessee for the purposes of income tax. To defeat that provision of law, a new partnership was executed on July 14, 1937, under which the mother of the assessee was substituted for his wife and children. The Court approved the scheme[8] and held that a man was entitled in law to arrange his affairs in any way he likes.

Tax avoidance operates in a thousand and one ways, depending on the nature and the legal effect of the particular transaction. The law discourages such types of anti-social conduct and tries to plug the loopholes in the law from time to time. In this way a constant battle is being waged between the specialists in avoidance of tax, acting for a small class, and the legislature, which represent the great body of taxpayers, as fast as the legislature closes one loophole, the tax-avoider discovers another loophole, and so the process goes on interminably.[9] In other words, it is a continuous battle of wits between the accountants, the lawyers and the Revenue[10].

However, it is not every tax saving device or

---

8. See Chapter 4 for Court's attitude to tax-avoidance.
9. 'Evasion of Income-Tax'(1941) 57 L.Q.R., p. 458.
10 'Tax Evasion and Avoidance: The Problem in the United Kingdom', A.R. Ileric, (1954) 2, Can. Tax. J. 377, 382.

transaction that is discouraged by law, and is prohibited, for in several cases the law itself encourages tax deductions, allows a number of concessions and gives allowances[11], rebates and reliefs[12] in various forms, for social, economic and fiscal reasons[13]. Similarly, the law would not disapprove an arrangement of one's affairs, if the operation was a bona fide commercial transaction and was not designed for the sole purpose of avoiding liability to taxation[14], even if it leads to the avoidance of taxes. Likewise, the law cannot compel a mean to earn money, when he voluntarily stops earning more than a specified income, in order to avoid a high rate of taxation[15]. In this way, tax avoidance may be explained in the words of Professor G.S.A.

---

11. See Tax Incentives as a Device for Implementing Government Policy: A Comparison with Direct Government Expenditure', Stanley S. Surrey, (1970) Mod. L.R. 705-38, Income Tax Act, 1961, sections 10 to 13 enumerate a long list of cases which do not form part of total income for the purposes of income tax.
12. Income Tax Act, 1961, provides reliefs in tax in certain cases, viz., when tax is paid on salary in advance (S.89), from double taxation (Ss. 90,91), to shareholders in respect of agricultural income tax paid by companies (S.235), to companies in respect of dividend paid out of past taxed profits (S.236) and to certain charitable institutions in respect of certain dividends (S.236A).
13. 'Tax Spring: An Instrument to Retain and Attract Foreign Capital, by M.C. Bijawat (1964)6 J.I.L. I. p. 236. Supra note 4, p. 209. See 'Tax Avoidance v. Tax Evasion by Sydney A. Gutking and David Beck, (Ronald Press Company Ltd.,) p.19. Sometimes the Government offers tax havens to those who establish a particular industry in which the Government is interested. This is done with a view to give an incentive to start a business.
14. Income Tax Act, 1961, section 93 (3)(b).
15. 'Canadian Report of the Royal Commission on Taxation', Vol. III, (1966), p. 539.

Wheatcroft:

> "As a transaction which (a) avoids tax,
> (b) is entered into for the purposes of avoiding tax or adopts some artificial or unusual form for the same purpose,
> (c) is carried out lawfully, and
> (d) is not a transaction which the legislature has intended to encourage."[16]

Thus, in order to bring a particular tax saving device or transaction within the scope of 'tax avoidance', the following elements must be present, viz.,

(i) there must be a tax gain or advantage,

(ii) there must be a motive to avoid tax,

(iii) the transaction must be carried out lawfully,

and (iv) The act must be against the legislative policy.

It is evident that tax avoidance is remunerative from the taxpayer's point of view and the Courts of law, in most countries of the world have joined hands with the ingenious taxpayer[17]. The Courts have upheld the right of a taxpayer to secure reduction in his liability by making use of loopholes and declared such transactions legal[18]. Nevertheless, the practice is undesirable from the national

---

16. Supra note 4 at p. 209.
    Similarly Harry J. Rudick states that:
    "...Tax avoidance covers every conscious attempt, successful or unsuccessful, to prevent or reduce income-tax liability by taking advantage of some provision or lack of provision in the law..."
    (1940), 7 Law and Contemporary Problems, 243, at p.245.
17. See Chapter 4, pp. 131, 132.
18. Supra note 3 para 7.3 at p. 147.

point of view[19], and leads to many evil consequences. The mere fact that the law is not violated does not mean that the act is justifiable[20]. Some of the main evil consequences of tax avoidance are as follows:

(1) Loss of Revenue to the State,

(2) inequality between taxpayers,

(3) it leads to tax evasion, and

(4) it wastes the community's intellectual manpower.

There are no official or unofficial statistics available, showing the amount of revenue lost through tax avoidance, nor is it possible to ascertain it. The reason is obvious. Any estimate of loss of revenue on account of tax avoidance would be merely hypothetical, as it would be a comparison of taxation actually paid with taxation that would have been paid but for the arrangement[21], and to obtain such statistics is virtually impossible. However, it is undisputable that the loss of revenue to the Exchequer due to illegitimate tax avoidance, i.e., avoidance which is against the policy and intent ...

---

19. Supra note 4, p. 212.
20. 'Report of the Taxation Enquiry Commission, 1953-54, Government of India, Volume 2, para 3 at p.189.
21. 'Taxation in Australia: Agenda for Reform', Melbourne University Press, (1964), p.128, see 'The Undivided Hindu Family: Its Tax Privileges' by I.S. Gulati and K.S. Gulati, (Asia Publishing House), 1962, pp. 31 to 71 for tax-avoidance by Hindu Undivided family. 'The Law of Federal Income Taxation', Randolph E. Paul and Jacob Mertens, Vol.5, section 53.30, p.853.

of the law[22] is enormous and it runs into millions; it has posed a constant problem to the State and the Exchequer. It is rightly remarked that tax avoidance poses a much more serious problem than tax evasion[23].

Tax avoidance, although not illegal in all cases, is nevertheless, inequitable [24] and leads to a sense of injustice[25] in society. The provisions of the taxation laws (including income tax and corporation tax) and the rates of taxes levied by the Government under Finance Acts passed from year to year are intended to secure a predetermined quantum of revenue, as specified in the budget of the year. If payment of a substantial amount of revenue is avoided by the ingenious use of the loopholes and the lacunas in law, it results in a loss to the Exchequer. This loss of revenue must be made good by the remaining body of taxpayers, who either are unwilling to frustrate the apparent intention of the legislature, or unable to profit by it, or have not the same knowledge[26] or opportunity for avoiding the tax[27] as the other taxpayers, who practice such tax avoidance methods have. For instance,

---

22. Supra note 5 at p.1.
23. Supra note 21, para 305, at p.130
24. Ibid, para 306 at p.131.
25. Supra note 15 at p.542.
26. Supra note 21, para 306 at p.131.
27. 'Labour and Tax Reform' by The Rt, Hon. Douglas Jay, P.C., British Tax Review, (1957) p.160.

to talk of tax avoidance in case of the salaried and wage earning class of people is futile, because in those cases taxes are deducted at source, i.e., by the employer at the time of disbursement of salary. In fact, it is a practice of wealthy people, i.e. big businessmen, industrialists and companies, who can employ ingenious lawyers and accountants to devise various schemes to outwit the Revenue. In this way, tax-avoiders enjoy the fruits of their ingenuity, not shared by the common people, without contributing their due share to the national revenue and thus bring inequality in the society.

As a result of widespread tax avoidance, which is mostly committed by persons falling in the upper strata of income groups, a feeling of injustice is created in the minds of those, who are less able to practice it, with the result that such tax payers are tempted to adopt various illegal means to evade payment of taxes lawfully due to the State. Tax avoidance leads to deterioration of tax morality as well.[28]

---

28. Supra note 15 p.542. see 'Judicial Techniques in Combating Tax Avoidance' by Ralph S. Rice, (1953) 51, Michigan L.R. 1021. The author has rightly pointed out that success in one transaction of tax avoidance schemes gives impetus to others to resort to similar devices and the chain goes on.

The ingenious taxpayers, on the one hand, employ the country's best lawyers and accountants to work out and plan devices to outwit the legislature and avoid tax; on the other hand, the Income Tax Department employs persons skilled in the art of combating such schemes. In this way, the community pays both sides in the tax avoidance battle[29], economically unproductive from the national point of view.

Methods of Tax Avoidance

Sagacious taxpayers, during the course of years have evolved a number of ingenious devices to avoid the impact of taxes, which might be considered their just burden of taxation. In fact, the process of evolution of tax avoidance schemes goes on continuously, though stopped from time to time by the legislature plugging the loopholes in the law. Tax avoidance schemes[30], in brief, may be

---

29. Ibid
30. The following are some of the tax avoidance devices in vogue in different countries, viz.:
    (i) United Kingdom : supra note 4 at pp.210,211.
        (1) Schemes which depend on getting the taxpayer or his property or both outside the jurisdiction of the U.K. tax laws.
        (2) The purchase of a defunct company, which has made a heavy loss, so as to use up that loss against future profit.
        (3) Taking in a new partner or retiring an old one, to claim a tax concession.
        (4) Accumulating income by means of a trust so as to avoid surtax.
        (5) Arranging for the tax avoider's income to come to him as capital. For example,

(Note continued on next page)

grouped into three parts, viz.,

---

30. (continued from previous page)
(a) letting property on a lease at a large premium with a much reduced rent, and
(b) selling securities just before the dividend is paid and repurchasing them after.
(6) Arrangements between a friendly employer and employees, which suit them both to the disadvantage of Revenue.
(7) Transferring income from a high surtax payer to someone who pays little or no surtax.
(8) Arranging expenditure in such a way as to qualify for deduction for tax purposes from his business, for example, by allowances to relations, paying charitable subscriptions and other domestic expenditures.
(ii) Canada : supra note 15, point 3 at pp. 539,540.
(a) Income splitting by means of intra-family arrangements, trusts and controlled corporations,
(b)"Dividend stripping", i.e., the distribution of corporate surplus, at less than the normal rates of personal or corporate tax.
(c) Purchasing a defunct company, which has incurred a heavy loss, in order to use that loss against future profits.
(d) Arranging transactions in such a way that what would normally be income is received as capital which is exempt from taxes.
(e) Transferring the income to a corporation or trust situated in a jurisdiction which levies tax at a nominal rate, or even no tax.
(iii) Australia : supra note 21, para 310, at p. 132 and para 351 at p. 148. Para 310 enumerates five kinds of tax avoidance schemes, namely,
(a) Splitting a tax payer's income among members of his family,
(b) Spreading income over a number of years, thereby reducing tax liability,
(c) Exploiting companies to reduce one's liability to pay tax on savings, or taking benefit of a lacuna in law available to a company but not to an individual taxpayer.
(d) Capitalizing a taxpayer's income, deducting capital expenditure from income or converting income into untaxed capital gains, and
(e) arranging affairs in such a way as to receive income in the shape of expense allowances or benefits in kind, which are not fully taxable, for instance,charging personal expenses as business expenses. Again para 351 at p. 148 lists four types of tax avoidance, viz.,

(continued on next page)

(i) income splitting,

(ii) income spreading, and

(iii) income transformation.

Income splitting is the method by which the income of a taxpayer, which is subject to a high rate of tax, is split into many parts, each part paying a lower rate of tax. Thus the aggregate tax payable would be less than what would have been payable otherwise. It may take place in several ways, for example, by the creation of family partnerships,[31] trusts, companies, or payment of

---

30. (continued from previous page)
(i) Purchasing securities with a low dividend yield but a high degree of expected capital gain, owing to rising dividend payments over time.
(ii) Purchasing Government bonds which provide discount and interest tax free,
(iii) Bond-washing and
(iv) Dividend stripping.
(iv) United States of America: see The Law of Federal Income Taxation' by Randolph E. Paul and Jacob Mertens, Vol.5, sections 53.35 at p. 859.

31. Supra note 21, para 312 at p.133 an interesting example of family partnership has been given.
Four brothers, who were carrying on business in partnership with their seventeen children as limited partners, created two trusts for each child with their grandfathers as settlers. They successfully claimed exemption from the payment of taxes on the ground that the partnership consisted of four brothers and thirty-four trusts. Thus, on the basis of the multiple trusts as partners, only £7,710 was payable in tax, whereas, if the income had been assessed on the four brothers - the original partners, the tax payable would have been £27,257 in the year 1939. See 'Income Splitting as a Means of Avoidance of taxes.' (1967) 2, I.T.J. 41 (Reproduction from Venderbilt Law Review). Balaji v. I.T.O., Special Investigation Circle, A.I.R. 1962 S.C. 123, 125.

salaries, interest or rent to their wives or children for nominal services. This device enables an assessee to secure the entire income of the business but at the same time evade payment of the whole income tax which he would otherwise have paid.

Income spreading is a device by which an assessee spreads his income and profits earned in one taxable year over a number of years. As a rule profits earned in one particular year should be taxed in that year itself. By adopting this device a taxpayer succeeds in paying only a portion of tax in one taxation year whereas the entire amount of tax is due. The aggregate tax payable over all the taxation years would be less than what would have been payable otherwise.

Income transformation is the most complex form of tax avoidance technique[32]. Income is divested into separate legal compartments, where it is taxed separately at a considerably lower rate or escapes it altogether, and after a while, the income comes back to the original taxpayer, or to a person whom he wishes to benefit. Some examples are bond-washing, dividend stripping and benami transactions.

---

32. '<u>The Use of Trusts and the Company for Tax Avoidance in Canada, the United States of America and Great Britain</u>', by Robert W.V. Diskerson (Ph.D. Thesis of University of London, 1965), p.114.

In bond-washing (i.e., selling securities before the dividend and repurchasing after) an arrangement is made by which a dealer in securities sells 'securities cum-dividend' to a tax exempt party and subsequently repurchases the securities ex-dividend. The capital loss suffered by the dealer may be offset against his other income and thus taxation liability is reduced.

Dividend-stripping is a form of transaction in which a finance-house purchases a company at a considerable higher price than the sizable value of its assets. Subsequently, a dividend is paid and the residual assets are sold at a loss. The amount of loss is deductible from the finance-house dividend income for tax purposes and the original company saves tax on the accumulated profits. Thus the tax saved is shared between the finance house and the original owners of the company.

A <u>benami</u> (ostensible ownership) transaction is a special type of transaction by which a person, instead of purchasing property in his own name, purchases it in the name of his wife, children or other near relative, so that he does not incur any taxation liability in the income of the property[33].

---

33. This type of transaction is very common in India and is in practice for quite a long time. J. Duncan M. Derret, '<u>A Critique of Modern Hindu Law</u>', (1970).See 103 at. p. 76.

Taxpayers in India resort to devices[34] similar to those practised in other countries[35] to avoid the incidence

---

34\. supra note 5. The author has enumerated some of the tax avoidance devices prevalent in India, in the field of partnership, private companies, trusts, charitable institutions, bond washing, dividend stripping and other types of transaction.
Income Tax Enquiry Report, 1936, (Government of India), in Chapter XII, Section I at p.65 has enumerated 12 types of tax avoidance methods prevalent in India at that time. Some are still in vogue in one form or the other. For instance,
(a) postponment of drawing of remuneration, resulting in a reduction in the rate of tax payable;
(b) the drawing of remuneration in the guise of allowances for expenses;
(c) the introduction into a registered firm of a partner for a short period only, so that an undue proportion of the firm's assessable profits is treated as his, or giving of a share in partnership profits to a near relative, e.g. the mother of the assessee.
(d) the formation by an assessee of a number of firms,
(e) the taking of usufructuary mortgages in respect of money lending transactions,
(f) interest on debentures which is due to a resident from another resident being made payable abroad,
(g) settlements and dispositions,
(h) non-distribution as income of a company's profits, and
(i) transfer of assets abroad.

Report of the Taxation Enquiry Commission, (1953-54), (Government of India), Vol.II, in Chapter 12, para 4 at p.190, states some examples of tax avoidance. These are the creation of corporate institutions, charitable trusts, the constitution of trusts and family partnership and the transfer of income earning assets to one's wife and children for fractioning income for tax purposes.

35\. See supra note 30 for tax avoidance devices practised in United Kingdom, United States, Australia and Canada.

of tax. However, there are three potential areas of special significance, in which tax avoidance is widely carried out in India and which are unknown elsewhere. These are in relation to joint Hindu family property, partnership business and religious and charitable endowments.

The Joint Hindu Family

The Hindu undivided family is a social institution peculiar to India[36]. It has been recognised by the Income-tax statutes as a distinct legal entity, i.e., unit of assessment for the purpose of taxation[37]. An individual

---

36. 'The Undivided Hindu Family: Its Tax Privileges', by I.S. Gulati & K.S. Gulati, (1962), at p.1. see 'The History of the Juridical Framework of the Joint Hindu Family', by J. Duncan M. Derrett, Contributions to Indian Sociology, No. 6, (1962), (Mouton & Co.), pp.1 to 47; 'Law and the Predicament of the Hindu Joint Family' by J. Duncan M. Derret, The Economic Weekly (Feb.13, 1960), pp. 305 to 311. 'The Law and Practice of Income Tax', by Kanga and Palkhiwala, 6th ed. Vol.I(1969), p.57. A Hindu undivided family consists of all persons lineally descended from a common ancestor and includes their wives, sons and unmarried daughters. Kalyanji Vithal Das v. C.I.T., (1937), I.T.R. 90 (P.C.) See 'The Joint Hindu Family : Its Evolution as a Legal Institution by G.D. Sontheimer, (Ph.D. Thesis, 1965, University of London, pp.2. 17 to 22)
37. Income Tax Act, 1961, section 2(31)(ii) and Income Tax Act, 1922, section 2(9) specifically provide that 'person' for the purposes of the Acts includes a Hindu undivided family. See I.T.O. v. Bachulal (1967)1,S.C.W.R.739; V. Venugepala v. Union of India A.I.R. 1969. S.G. 1094. See 'The Relation between Social and Economic Development of Society and the Development of Law: Hindu Law in India' by J. Duncan M. Derrett, A.I.R. 1970 Journal 2.

member of the Hindu undivided family is not subject to taxation in respect of income received by him from the Hindu joint family. The Income Tax Act, 1961, like the Act of 1922, has given certain privileges to the Hindu undivided family not available to other individual taxpayers. For example, the minimum exemption limit for the purposes of imposition of tax[38] and allowances claimable against the taxable income in case of a Hindu undivided family is much higher than that of the other taxpayers.[39]

But a Hindu undivided family like other taxpayers, does not appear to be content with what the legislature has conferred upon it. It adopts a number of undesirable methods to reduce the impact of taxes. The main devices are partition of the family assets and transfer of the joint family property within the family which require elucidation.

---

38. The Finance Act (19 of 1970), 1st Schedule, paragraph A provides that tax shall not be levied in the case of H.U.F. unless the income exceeds Rs. 7,000 and in case of an individual Rs. 5,000 per annum.
39. '<u>The Relation between Social and Economic Development of Society and the Development of Law: Hindu Law in India</u>', J. Duncan M. Derrett, A.I.R. 1970, p.2. The differential treatment in the case of a Hindu undivided family has been criticised on the ground that it violated the provisions of the Constitution that the State shall not discriminate between individuals on the ground of religion. It is said that Muslim families are deprived of the advantages available to the Hindu undivided family. However, the Supreme Court in <u>V. Venugopala</u> v. <u>Union of India</u>, A.I.R. 1969 S.C. 1094 has approved of the scheme and held <u>intra vires</u> the Constitution.

The partition of the joint family assets is perhaps one of the easiest and simplest methods to avoid taxes. The moment the income of a Hindu undivided family exceeds the exemption limit prescribed for the purpose of taxation, or the income falls within a higher income group which is subject to a higher rate of tax, the family effects partition of the joint family property[40]. Partition may be total or partial[41]. In case of total partition, the entire assets of the family are divided amongst the coparceners according to their individual shares in the joint family, whereas in the case of partial partition the division takes place only in respect of certain assets of the family, generally business assets, and the family remains joint in other respects[42]. Generally after partition the members

---

40. Supra note 36 at pp.32 to 53.
41. Income Tax Act, 1961, section 171. A Hindu undivided family seeking partition is required to apply to the Income-tax Officer to record the date on which the partition has taken place. It is only after the Income-tax Officer's finding that partition has taken place that the Hindu undivided family will be deemed to have come to an end for the purposes of assessment of tax. Udayan Chinubhai v. C.I.T. (1967) 63 I.T.R. 416 (S.C.).
42. See supra note 36 at pp.32 and 51; see supra note 39, p.2. Partition need not be physical in all cases. It depends on the nature of property in question. In case of a H.U.F. carrying on business, division may take place by simply making appropriate entries in the account books.

of the erstwhile joint family draw up a partnership deed consisting of the same members as individuals and get the firm registered under section 185 of the Act of 1961[43].

As a result of all this the income of the family is divided into a number of separate units, each assessable in the hands of individual coparcerners at a considerably lower rate as compared with that payable by the undivided joint family. An illustration will show how the exemption limit of tax is raised by partition and thereby total tax payable is reduced. If a Hindu undivided family, consisting of five coparceners, resorts to partition, each of them will be separately liable to tax on his individual income. Thus the exemption limit of Rs. 7,000 prescribed for the Hindu undivided family is raised to 25,000 because the individual members will be taxed on their minimum taxable income of Rs. 5,000. In this way the actual payment of tax by a Hindu undivided family which has not undergone partition would be much higher than one which has resorted to partition.

Unfortunately, the legislature has not made any

---

43. The registration of a partnership may be refused, if it is not genuine and has been merely a cloak to avoid tax liability. See Sunder Singh Majithia v. C.I.T. (1948) 10 I.T.R. 457, 461-462 (P.C.); Lachiram Baldeo Das v. C.I.T. (1934) 4, I.T.R. 279.

provision to discourage a Hindu undivided family from effecting a partition which is intended merely to reduce the impact of taxes. The Courts also have not questioned the desirability of such a transaction. Rather they have approved of it[44].

It would be desirable on the part of the Courts to disapprove of a scheme of partition made simply to defraud the revenue. In other words, if a partition is sham and not real, it should not be recognized, as in the case where a firm's registration is refused under section 185 of the Act of 1961, if the partnership is not genuine.

The second device which is used by a Hindu undivided family to reduce the impact of taxes is either to alienate the family assets to one or more of the co-parcerners[45] or to finance from the family funds an

---

44. Kathirvelu Nadar v. Commissioner of Agricultural Income Tax (1968) 68 I.T.R. 786; Sulakhe v. C.I.T. (1960) 39 I.T.R. 394; Aruna Group of Estates v. State of Madras (1965) 55 I.T.R. 642; see supra note 36 pp. 34 to 71 for the amount of tax lost through tax avoidance by the Hindu undivided family.
45. Similarly members of a Hindu joint family in order to avoid the impact of gift tax throw their self acquired property in the common hotchpot of the family instead of making a gift of the property. The Supreme Court in a recent case Goli Eswarian v. Gift Tax Commissioner, A.I.R. 1970 S.C. 1722, approved of a similar device and held that the act of throwing self-acquired property into the common stock of family, did not amount to transfer of property within the meaning of section 2(xxiv)(d) of the Gift Tax Act (18 of 1958), so as to attract tax. The following cases were overruled which had taken a contrary view. Commissioner of G.T. v. Jagdish Saran (1970) 75, I.T.R. 529; G.V. Krishna Rao v. Ist Additional G.T.O., 1970 A.P. 126; Commissioner of G.T. v. Satyanarayananamurthy, A.I.R. 1965 A.P. 95. See Inaugural Address by P.C. Sethi, 4th All India Conference of Tax Executives, New Delhi, (1970), pp. 6, 7.

Individual member or to employ a coparcerner to participate in an undertaking financed by joint family funds and to earn a salary or remuneration for his exclusive use[46]. As a result the family property is diverted into different channels; each claiming assessment in its own right, as the self acquired property of the earner himself[47], and thereby reducing the incidence of tax.

The question that arises in this connection is whether the profits accrued from such transfers of the joint family assets or salary earned by a coparcerner in an enterprise financed by the joint family funds are separate income of the person to whom it was purported to have been given and taxable as his income or that of his family, the coparcerner being simply a dummy for the purpose.

---

46. See for detailed discussion on the subject following articles by Professor J.Duncan M. Derrett:
(i) '<u>The Relation between Social and Economic Development of Society and the Development of Law: Hindu Law in India</u>', A.I.R. 1970, p.3.
(ii) '<u>Acquisition of Joint Family Property, How the Presumptions Operate</u>' (1967) 69, Bom. L.R., pp. 1-7.
(iii)'<u>Acquisition of Joint Family Property Through a Coparcerner: Let Sastric and Equity Principles Join Hands</u>',(1969) 71 B.L.R.J., pp. 75-81.
(iv) '<u>Acquisition of Joint Family Property and Recent Decisions of the Supreme Court</u>', 1 S.C.W.R. pp. 19, to 25; (1969) K.L.R.J. pp. 37 to 42.
(v) '<u>The Supreme Court and Acquisition of Joint Family Property</u>', (1960) 62 B.L.R. pp. 57 to 71.
(vi) '<u>The History of the Juridical Framework of the Joint Hindu Family</u>; Contributions to the Indian Sociology, Vol.6 (1962), S.O.A.S.,University of London, pp. 7-47.
(vii) '<u>A Critique of Modern Hindu Law</u>' (1970) para. 90-106, pp. 62 to 78.
(viii) '<u>Law and the Predicament of the Hindu Joint Family</u>', (1960, Feb.13) The Economic Weekly, pp. 305-311.
(ix) '<u>The Supreme Court and the Acquisition of the Hindu Joint Family Property</u>', (1971) 1 S.C.W.R. 7-10.

47. <u>Ibid</u>. sub-note (iii) at p.76.

The legislature, as usual, is silent on the issue and has provided no answer to the problem.

However, it appears that the judiciary has taken note of it, and the Supreme Court has enumerated a number of tests[48] in order to find out whether a given income is the separate property of the person to whom it purports to have accrued or that of the joint Himdu family. But perhaps the law cannot yet be said to be settled beyond controversy.

The earliest case on the point is that of Gokul Chand v. Hukum Chand Nath Mal[49], in which their Lordships of the Judicial Committee held that a Hindu undivided family is entitled to demand the income from a coparcerner, if the joint family fund was used for his education. It was observed that there could be no valid distinction between a direct use of the joint family funds and a use which qualified the members to make the gain by his efforts.

---

48. Raj Kumar Singh Hukam Chandji v. C.I.T., M.P. (1970) II S.C.W.R. 674, at p. 685, 686. The Court has summarized the tests invoked in deciding cases. These are:-
(i) Whether the income received by a coparcenner of a Hindu undivided family as remuneration had any real connection with the investment of the joint family funds,
(ii)whether the income received was directly related to any utilization of the family assets,
(iii)whether the family has suffered any detriment in the process of realization of the income and
(iv) whether the income was received with the aid and assistance of the family funds.

49. (1921) 48 I.A. 162 (P.C.).

The case aroused much controversy and public dissatisfaction, with the result that the Hindu Gains of Learning Act, (30 of 1930) was passed to nullify the effect of this decision.

Thereafter came decisions of the Supreme Court. There are about eleven cases[50] decided by the Supreme Court on the point, starting from C.I.T., West Bengal v. Kalu Babu Lal Chand [51] which was decided in 1959, and going on to Raj Kumar Singh Hukam Chand v. C.I.T., M.P.[52] and Prem Nath v. C.I.T., Delhi and Rajasthan [53] decided in 1970.

In all these cases the facts were similar. The joint family property was invested to acquire a benificial interest in some business concern, a company or a partnership and the Karta of the family was appointed manager or managing director of the concerns on a handsome salary or remuneration.

The Supreme Court applied the Doctrine of nexus, i.e., whether there was a real and sufficient connection

---

50. Mathura Prasad v. C.I.T. (1960) 60, I.T.R. 428 (S.C.) Piyeare Lal Adishwar Lal v. C.I.T. A.I.R. 1960 S.C. 997; V.D. Dhanwatey v. C.I.T., M.P., (1968) 1 S.C.W.R. 595; M.D. Dhanwatey v. C.I.T., M.P. (1968) I.S.C.W.R. 463; Palaniappa Chettiar v. C.I.T., Madras (1968) I.S.C.W.R. 495; C.I.T., Madras v. Gurunath Dhakappa (1968) 2 S.C. W.R. 237; P.N. Krishna Iyer v. C.I.T., Kerala (1968) 2, S.C.W.R. 472; C.I.T., Mysore v. D.C. Shah (1969) I; S.C.W.R. 417. See for other 3 cases notes 51 to 53.
51. A.I.R. 1959 S.C. 1289.
52. (1970) 2 S.C.W.R. 674.
53. (1970) 2 S.C.W.R. 545.

between the investment from the family funds and the remuneration paid to the coparcenner. If, the answer was in the affirmative, the income was to be treated as the income of the joint family; otherwise it would be that of the individual member.

The Court has summarized the law on the point very lucidly in one of its latest cases, Raj Kumar Singh Hukum Chandji v. C.I.T., M.P., wherein it was stated that:

> "...Whether the remuneration received by the coparcerner in substance though not in form was but one of the modes of return made to the family, because of the investment of the family funds in the business or whether it was a compensation made for the services rendered by the individual coparcerner. If it is the former, it is an income of the Hindu undivided family but if it is the latter then it is the income of the individual coparcerner. If the income was essentially earned as a result of the funds invested, the fact that a coparcerner has rendered some service would not change the character of the receipt. But if, on the other hand, it is essentially a remuneration for the services rendered by a coparcerner, the circumstances that his services were availed of, because of the reason that he was a member of the family, which had invested funds in that business or that he had obtained the qualification shares from out of the family funds would not make the receipt, the income of the Hindu undivided family." [54]

Their Lordships, while applying the above test of reasonable and sufficient connection, decided five cases in favour of the revenue and six in favour of the individual coparcerners.

The cases decided in favour of the revenue are those cases in which the Courts have upheld the claim of the

---

54. (1970) 2 S.C.W.R. 674 at p. 686.

family that the income earned by a coparcener in an enterprise financed by the joint family funds belonged to the family and not to the individual member. These cases are discussed below in chronological order.

The first case in the series is that of C.I.T., West Bengal v. Kalu Babu Lal Chand[55]. The facts of the case are that a Hindu undivided family put up almost the entire capital of a company named the Indian Electric Works and so acquired a majority interest in its business. The Karta (manager), of the family was one of the promoters of the company and was appointed as its managing director on a substantial salary.

It was held on the facts of the case that the remuneration earned by the Karta of the family was income assessable as part of the income of the Hindu undivided family. It was observed that the acquisition of the business, the floating of the company and the appointment of the managing director were inseparable and part and parcel of one scheme. Thus there existed a nexus between the expenditure of the joint family and the earnings by the Karta of the family.

The second case is Mathura Prasad v. C.I.T.[56]. The facts of the case are more or less similar to those

---

55. A.I.R. 1959 S.C. 1289.
56. (1960) 60 I.T.R. 428 (S.C.).

in Kalu Babu Lal Chand discussed above. The appellant, as karta of a joint Hindu family, entered into a partnership in a firm, the Agrawal Iron Works, for the benefit of the family. Joint Hindu family funds were used to acquire the share in the firm and the appellant Karta, as partner in the firm, was entrusted with its management, for which he was to get certain allowances.

It was held that the allowance received by the appellant belonged to the Hindu undivided family, because the allowance received by Mathura Prasad was directly related to the investment of family funds in the firm's business.

The third case is V.D. Dhanwatey v. C.I.T., M.P.[57] The appellant, as the karta of a Hindu undivided family, was a partner of a firm. The family on his behalf contributed capital, on which interest was payable to the Hindu undivided family. Under the deed of partnership, the appellant was entrusted with the general management and supervision of the firm and he was to be paid a monthly remuneration out of the gross earning of the partnership business.

It was held by a majority of the Court that as the remuneration paid by the firm to the appellant was directly related to the investment in the partnership business from the assets of the family, and that there was

57. (1968) 1 S.C.W.R. 595.

a real and sufficient connection between the investment from the family funds and the remuneration paid to the appellant, the salary paid to the appellant was assessable as the income of the Hindu undivided family.

The fourth case is M.D. Dhanwatey v. C.I.T., M.P.[58] The facts of this case are identical with those of V.D. Dhanwatey (discussed above) and was decided by the Court on same day, i.e., October 27, 1967.

The appellant, as karta of a joint Hindu family, was a partner in a firm and the family contributed his share in the capital. According to the partnership deed the appellant was to act as a manager of the firm and was to receive a monthly salary.

It was held that the salary should be included in the total income of the joint Hindu family for the purposes of taxation, as there was a direct connection between the appointment of the appellant as the manager of the firm and the investment of the family.

The fifth and last case in the series is of P.N. Krishna Iyer v. C.I.T., Kerala.[59] The facts found in this case are that the appellant, the karta of a joint Hindu family, received a salary, commission and a sitting fee as governing director of a private company, which

---

58. (1968) I,S.C.W.R. 463.
59. (1968) 2 S.C.W.R. 472.

carried on a transport business. The shares which qualified the karta to become a member of the company were purchased with the aid of the joint family funds, and the entire capital of the company originally belonged to the Hindu undivided family.

On the facts of the case, it was held that the income belonged to the Hindu undivided family, because it was primarily earned by investing the joint family assets. Their Lordships observed that the mere fact that, in the process of deriving benefit, an element of personal service or skill or labour was involved, did not change the character of the income. It was further held that the nature of the income had to be determined by reference to its source, its relation to the assets of the family of which the recipient was a member and the object with which the benefit received was disbursed.

Now we come to those cases which were pronounced in favour of individual coparcerners and against the joint family and revenue's interest. In other words, these are the cases in which the Courts have held that there were no real and sufficient connection between the investment from the joint family assets and the remuneration earned by the coparcerner concerned, so the income was adjudged to be the individual income of the member in question and assessable in his hands.

In <u>Piyeare Lal Adishwar Lal</u> v. <u>C.I.T.</u>,[60] one Sheel Chand, who was <u>karta</u> of an undivided family, consisting of himself and his younger brother, gave joint family properties as security for his appointment as treasurer of a bank. He would not have been appointed but for the security.

However, the Court negatived the Commissioner's contention that the salary earned by Sheel Chand was family income. The income was not the fruit of the family's investment. In fact, it was the reward of the coparcerner's skill. It was further held that the family was not at any real loss, because it earned interest over the security money, and so the income was adjudged to be assessable as Sheel Chard's separate income.

In <u>C.I.T., Mysore</u> v. <u>Gurunath Dhakappa</u>,[61] the <u>karta</u> of a Hindu undivided family, who was a partner in a firm, representing his family, was appointed manager of the firm on a salary of Rs. 5000/- per month.

It was held that in the absence of a finding that the salary received by the <u>karta</u> had a direct relation to the assets of the family, the income was assessable as his separate income.

---

60. A.I.R. 1960 S.C. 997.
61. (1968) 2 S.C.W.R. 237.

In Palaniappa Chettiar v. C.I.T., Madras,[62] the karta of the family bought 90 out of 300 shares in a transport company with the family funds. The karta of the family was appointed a director and later its managing director. He was entitled to a salary and a commission on the net profits of the company in lieu of salary for his services as managing agent.

It was held that the karta was entitled to the remuneration in his personal capacity and the amount was assessable to income-tax as his individual income, because there had been no detriment to the family fund and no part of the family capital had been spent for the purposes of acquiring the allowances to the karta. In other words, there was no real connection between the investment of the joint family funds in the purchase of the shares and the appointment of the karta as managing director of the company.

In another case C.I.T., Mysore v. D.C. Shah,[63] the Court arrived at a similar conclusion. Therein the respondent, a Hindu undivided family, was the partner in two firms through its karta. Mr, Shah was appointed as managing partner of the two firms and was paid substantial remuneration on that account.

---

62. (1968) I,S.C.W.R. 495. C.I.T., Madras v. Sankaralinpa Ayyar A.I.R. 1950 Mad. 610.
63. (1969) I,S.C.W.R. 417.

The Court distinguished the case from other similar cases discussed earlier[64], on the ground that there had been no real and sufficient connection between the investment of the joint family funds and the appointment of Mr. Shah. It was held that Shah was appointed because of his 'rich experience' in the line of business which the two firms were carrying on and that the remuneration was not earned on account of any detriment to the joint family assets. It was, therefore, held that the income was not assessable as the income of a joint Hindu family but as his individual income.

Similarly, in a recent case, Raj Kumar Singh Hukum Chandji v. C.I.T., M.P.,[65] it was held that the remuneration received by the karta of a Hindu family, as one of the managing directors of a firm in which the family had acquired an interest, was the individual income of the respondent. It was held that the karta did not become the managing director of the firm solely because his family had purchased a considerable number of shares in the firm but because of his personal qualifications; he was elected to the post by the Board of Directors.

---

64. V.D. Dhanwatey v. C.I.T.,M.P., A.I.R. 1968 S.C. 683; M.D. Dhanwatey v. C.I.T., M.P., A.I.R. 1968 S.C. 682; P.N. Krishna Iyer v. C.I.T., Madras, (1968) 2 S.C.W.R. 472; C.I.T., West Bengal v. Kalu Babu Lal Chand, A.I.R. 1959 S.C. 1289; Parbati Kuer v. Sarangdhar, A.I.R. 1960 S.C.403; Rameshwar Prasad v. C.I.T., Allahabad, A.I.R. 1968 All.88.
65. (1970) 2 S.C.W.R. 674

Again in <u>Prem Nath</u> v. <u>C.I.T., Delhi and Rajasthan</u>[66], the Court held that the allowance received by the <u>karta</u> of the Hindu undivided family, as amanaging partner in a firm in which he represented his family, was his individual income for rendering services.

On a careful analysis of the above cases, one comes to the conclusion that the Courts have made a distinction between the remuneration earned by a coparcerner as a result of investment made by a joint family funds in an enterprise and the remuneration earned on account of his personal skill. If the remuneration is earned due to the coparcerner's personal skill, the connection between the investment of the joint family funds and the earnings of the coparcerner will be held to be too remote to be adjudged the earnings of the joint family.

The proposition may appear sound but in actual practice its application is unfair. For instance, if an intelligent taxpayer, in order to avoid the incidence of tax, as stated by Professor Derrett[67], was cautious enough simply to add in the deed of agreement of the concern, in which the interest had been acquired by the joint family

---

66. (1970) 2 S.C.W.R. 545.
67. <u>Supra</u> note 46 (iii) at p. 76.

funds, that the coparcerner was appointed because of his 'rich business experience'[68] or beaause of his 'great personal qualifications'[69], or because of his'personal skill and services'[70] it would be held that there was no real and sufficient connection between the investment and the remuneration, no matter how substantial the family investment might have been[71]. This can hardly be justified.

Again, under the present rule, where the family contributes 30 per cent. of the capital in a concern, the member would be entitled to keep all his earnings on the ground that there was no 'real and sufficient connection' between the investment and the earnings[72].

In such cases, as suggested by Professor Derrett, who has very carefully dealt with this topic in various places[73], there should be an evaluation of the family's right as against the individual's right and a balance should be maintained between the two interests. In other words, the doctrines of 'real and substantial' test should be replaced by the doctrines of 'proportional entitlement', i.e. the family should be entitled to the income

---

68. C.I.T., Mysore v. D.C. Shah (1969) I,S.C.W.R. 417.
69. Raj Kumar Singh Hukum Chandji v. C.I.T. M.P., (1970) 2 S.C.W.R. 674.
70. Prem Nath v. C.I.T. Delhi, (1970) 2 S.C.W.R. 545.
71. See supra note 46 (iii) at p.76.
72. See ibid 46 (iv) at p.24.
73. See ibid.

proportional to its contribution, subject to the claim of the individual coparcerner contributing his skill evaluated in terms of a percentage contribution[74]. For instance, if a Hindu undivided family invests capital in a concern and one of its coparcerners uses his 'rich business experience', the interest of both the family and the coparcerner should be assessed while distributing their share in the earnings.[75] At times the gains from 'personal experience' might be proportional to the family investment and then both would be entitled to equal shares in the earnings.

But where the karta of the joint family or some other coparcerner places himself in such a position that he derives certain advantages by virtue of his status in the family, his position is that of a constructive trustee for the person or persons towards whom he stands in that fiduciary capacity, in regard to the gains derived out of that act. And such a person is accountable to the principal, i.e., joint Hindu family for the advantages derived and the earnings belong to the family and not to

74. Supra note 46(iii) at p. 78.
75. Supra note 46(iv) at p. 24. The author has traced the law on the point in the old Hindu law. He has cited authorities stating that 'gains are proportionate to the investment, unless the partners otherwise agree'. A somewhat similar doctrine is applied in the law of torte while apportioning liability between the plaintiff and defendant in case of contributory negligence, and the parties are asked to contribute in that proportion.

him.[76]

Perhaps this would be the best proposition in the circumstances; otherwise a joint family enterprise could become a cloak behind which ingenious taxpayers in the family could hide their individual interests at the expense of the family and the revenue,

Partnership

The Income-tax statutes in India[77] have recognized a partnership[78] as a unit of assessment[79] like the Hindu undivided family. Thus a firm is an assessee under section 2(7) of the Act of 1961 and is subject to tax, irrespective of whether it is registered under section 185 of the Act, or not, like other assessees at the rate or rates prescribed by the Finance Act of the year.

---

76. This corresponds to a rule of equity. See *supra* note 46 (iii) at p.73. *Messrs. Pierce Leslie* v. *Violet O. Wapshare* A.I.R. 1969 S.C. 843; *Boardman* v. *Phipps* (1966) 3 All. E. R. 721 (H.L.).
77. Income Tax Act, 1922, provided for assessment of firms under section 23(5) of the Act.
78. The definition of the firms, partners and partnership will have the same meaning as in the Indian Partnership Act (9 of 1932). Income Tax Act, 1961, section 2(23).
79. Income Tax Act, 1961, section 2(31)(iv) read with section 4(1) and section 2(7) state this fact. See *C.I.T.* v. *Figgies and Company*, (1953) 24 I.T.R. 405,409 (S.C.); *NarayanaChetty* v. *I.T.O.* (1959) 35 I.T.R. 388,393-5 (S.C.); *I.T.O.* v. *Radha Krishna* A.I.R. 1968 S.C. 46 at p.47. Similar view has been taken in the United Kingdom regarding firms, i.e., they are assessable by the House of Lords in the *Income Tax Commissioner of the City of London* v. *Gibbs* (1942) 10 I.T.R. Suppl.121 (H.L.). However, a firm is not a legal entity under the general law. *Dulichand Laxminarayan* v. *C.I.T.*, (1956) 29 I.T.R. 535 (S.C.)

It may be noted that in 1930, by the Income Tax Amendment Act (21 of 1930), firms were placed in two categories, namely registered[80] and unregistered[81] for the purposes of assessment and collection of tax. A firm registered under the provisions of the Act[82] enjoys the benefits of lower rates of taxation than unregistered firms. However, the registration of firms is optional on the part of partners, and the law does not impose any obligation to get the firm to register.

In the case of registered firms, the firm is assessed to tax at a specially low rate[83] and the partners are individually taxed on the basis of their total income,

---

80. 'New Law Regarding Registration of Firms' by G.C. Sharma Tax Consultant Conference (1964), Souvenir, pp.115,116; Income Tax Act, 1961, section 182 provides for assessment of 'registered firms'. See for 'Registration of Firms: Some Problems', K. Ponnuswami (1964) 6 J.I.L.I.54 to 68.
81. Income Tax, 1961, section 183 provides for assessment of unregistered firms. Registration of firms takes place from the date the Registrar makes an entry in the Register of firms and not from the date application was sent for registration, C.I.T., A.P. v. Messrs. Jayalakshmi Rice and Oil Mills, 1971 I.S.C.W.R. 183.
82. It was held by the Mysore High Court in Adinarayan Setty v. I.T.O. (1964) 52 I.T.R. 987, that the provisions relating to assessment of registered and unregistered firms on a different footing was not unconstitutional.
83. Until 1956 there was no provision for assessment of tax in case of registered firms. It was only by the Finance Act, 1956, that the assessment in case of registered firms started.

including their share of the firm's profits. A partial relief is given against double taxation by section 67(1)(a) of the Act[84]. In the case of unregistered firms, the tax is payable by the firm itself on the total income of the firm as a distinct legal entity and no tax is payable by the partners individually with the result that the total tax payable by an unregistered firm is generally greater than that payable by the partners in registered firms, because the rate of tax is higher on a higher level of income. In addition to the above advantage, a partner in a registered firm is entitled to claim a set off in case of loss against his other income or carry forward and set-off in accordance with the provisions of sections 70 to 75 of the Act[85].

This artificial distinction created between registered and unregistered firms is uncalled for. It has created a lot of problems both for the revenue and the taxpayers. A constant battle goes on between taxpayers seeking registration of firms and the revenue refusing either

---

84. On principle the same income cannot be taxed twice in the hands of the same person. Madanlal Dharnidharka v. C.I.T., (1948) I.T.R. 227,236. The Central Government may enter into agreement with Foreign countries for the granting of relief in case of double taxation or for the avoidance of double taxation. Income Tax Act, 1961, sections 90 and 91.
85. See 'The Law and Practice of Income Tax' by J.B. Kanga and N.A. Palkhiwala, Vol.I, (6th ed., 1969) at p.875.

on some technical ground[86] or on the basis that firm is not genuine and only a device to defraud the exchequer[87].

It would be in the fitness of things that this artificial distinction between the registered and unregistered firms should be abolished. All firms should be treated alike and be assessed as a distinct taxable entity falling in one class and subject to a progressive rate of tax[88]. And whatever allowance the legislature wants to extend to a firm carrying on business should be extended to all. This

---

86. Income Tax Act, 1961, section 184 to 186 provide for registration of firms. The Act lays down the following conditions for registration of firms:
(1) An application should be made to the Income-tax Officer before the end of the accounting year.
(2) The firm should be evidenced by a partnership deed.
(3) The document should mention the share of individual partners in the firm, and
(4) The firm should be genuine and valid.
87. See supra note 85 at pp.886,887. The Income-tax Officer may refuse to register a partnership in case it is made to defraud the revenue and is not real. Sundar Singh Majithia v. C.I.T. (1942) I.T.R. 457,461-62 (P.C.); Raju Chettiar and Brothers v. C.I.T. (1949) I.T.R. 51,62. However, bare suspicion will not justify the inference that the partnership was not real. Umacharan Shaw and Brothers v. C.I.T. (1959) 37 I.T.R. 271. C.I.T.,M.P. v. Hukumchand Mannalal, A.I.R. 1971 S.C. 383. The Income-tax Officer is not concerned to determine in whom the beneficial interest in the share in the partnership rests, while granting registration under section 26A of the Act of 1922. The same is true in regard to the present Act of 1961.
88. See supra note 80 at p.124. Similar views have been expressed for the abolition of the artificial distinction between registered and unregistered firms.

will have a double advantage over the present scheme of registration of firms. Firstly, it will remove the feeling of injustice experienced by unregistered firms and discourage the crafty taxpayer from seeking registration in order to avoid taxes. Secondly, it will save a lot of time for the Income Tax Department, which is now being wasted in the process of registration with no gain to the revenue. It will also reduce unnecessary litigation and close one of the potential areas of avoidance of tax.

Religious and Charitable Endowments[89]

The institutions known as religious[90] and charitable[91]

---

89. '*The Hindu Law of Religious and Charitable Trusts*' by B.K. Mukherjea (Tagore Law Lectures 1936), 2nd ed. 1962. The author states at p.3 that "A trust would be denominated a religious or charitable trust, if it is created for purposes of religion and charity."
90. *Ibid* at pp. 3,4.B.K. Mukherjea states, regarding "... religious purposes" ... R eligion is absolutely a matter of faith with individuals or communities... All that we understand by religious purpose is that the purpose or object is to secure the spiritual well being of a person or persons according to the tenets of the particular religion which he or they believe in."
91. *Ibid*. Mr. B.K. Mukherjea states in relation to charity, that "By charity... is meant benevolence, and in its wide and popular sense it comprehends all forms of benefit, physical, intellectual, moral or religious, bestowed upon persons who are in need of them." Income Tax Act, 1961, 2(15) defines "Charitable purpose" as including relief of the poor, education, medical relief, and the advancement of any other object of general public utility not involving the carrying on of any activity for profit. See *Commissioner for Special Purposes of Income Tax* v. *Pemsel* (1891) A.C. 531.

trusts[92] and endowments[93] are among the most ancient and well developed institutions in India[94]. Properties dedicated to such institutions were generally exempt from taxation or were taxed at nominal rates[95]. The same is true of the present day revenue legislation. And the Income Tax Act since its beginning recognized that income from properties held under such trusts and endowments are exempt from purview of taxation[96].

However, ingeneous taxpayers in course of time exploited these sacred institutions for their personal advantage. Rich taxpayers have sought to reduce their tax liability by creating religious and charitable

---

92. See supra note 89 pp. 5 to 7 for definition of Trust. See also Indian Trusts Act (2 of 1882). 'Trust in the United States Entity in Federal Income Taxation' by W. H. Horror (1940-41), 25 Minn. L.R. 189; see Burnet v. Wells (289) U.S. 670 to 685 (1933), in which the United States Supreme Court has discussed in detail assessee's liability to pay tax in case of trust.
93. By 'endowment' is meant, that, which is settled on any person or institution.
94. Supra note 89, at pp. 1,2.
95. See 'Tax Exemptions in Ancient India' by N.N. Kher (1963) 39, Indian Historical Quarterly, pp. 59 to 68, for different types of exemptions available to a taxpayer. 'The Liabilities of Deities to pay Taxes', by J. Duncan M. Derrett, (1969), 71, Bom. L.R., 38,39. See 'Religious Endowments in India: The Juristic Personality of Hindu Deities', by Günther - Dietz Southeimer, (1965) 7, Zeithschriff für Vergleichende Rechtswissenschaff, 45-100 (A German Journal).
96. Income Tax Act, 1886, section 5(1)(e), Income-tax Act, 1918, section 3(2)(i) and (ii), Income-tax Act, 1922, section 4(3)(i) and (ii); Income-tax Act, 1961, sections 11-13.

institutions and claiming exemption from taxation. As a result the legislature has gradually limited the scope of exemptions allowed and fixed a maximum amount exempt from taxation[97]. For instance, under the Income Tax Act of 1922, there was no restriction upon the accumulation of income from the trust property and it was exempt from taxes under section 4(3)(1)(ii) of the Act, whereas under the Act of 1961, any income accumulated in excess of 25 per cent. of the total income of the trust or Rs. 10,000, whichever is higher, is taxable under section 11(1)(a), unless the accumulation is made according to the conditions set out in section 11(2) of the Act[98]. Again, a charitable trust, created after the coming into force of the Income Tax Act, 1961, is not entitled to exemption if: (i) the trust property is held in part only for charitable purposes[99], or (ii) the trust is for the benefit of any particular religious community or caste[1], or (iii) any part of the

97. The first major concerted effort in the direction of stiffening the law was made in 1956 by the Income Tax Amendment Act (25 of 1953). The second was by the Finance Act, 1955. See <u>supra</u> note 85, pp.196-198.
98. The Income Tax Act, 1961, section 11(2) lays down two conditions for accumulation of profits, viz.,
(1) the purpose of the accumulation must be intimated to the Income-tax Officer, and
(2) the money so accumulated must be invested in Government securities.
99. Income Tax Act, 1961, section 11(1)(b).
1. Income Tax Act, 1961, section 13(b).

income is meant directly or indirectly for the benefit of the creator of the trust or his relatives[2]. The legislature has also imposed certain conditions on a grant of exemption from taxes, viz.,

(1) the property from which income is earned must be held under a trust,

(2) the property should be held wholly or partly for charitable or religious purposes[3],

(3) the income must be applied to such purposes, and

(4) the exemption from taxes is limited to 25 per cent or Rs. 10,000 as stated above.

The attitude of the Judiciary in regard to the interpretation of these provisions when exemption from taxes is claimed does not appear to be satisfactory from the revenue point of view. The Courts have unduly favoured the taxpayers seeking exemptions and sometimes have even ignored the ordinary plain meaning of the statute in question.

In J.K. Trusts, Bombay v. C.I.T., Bombay[4], the Supreme Court held that a trust could carry on business, which had

---

2. Ibid. See supra note 85, p.243 for changes made by the Income Tax Act, 1961.
3. 'Taxation of Charities and Trusts' by T.V. Viswanath Aiyar, (1963), Lawyer, pp. 321-41; see Guru Estate v. C.I.T., Bihar and Orisa, A.I.R. 1963 S.C.1452. See 'The Juristic Personality of Deities in Hindu Law' J.A.S. Natraja Aiyar, (1954), 3, Vyavahara Nirhaya 106-177 (Law Faculty, University of Delhi).
4. A.I.R. 1957 S.C. 846. See Trustees of the Charity Fund v. C.I.T., Bombay, A.I.R. 1959 S.C. 1060.

nothing to do with the primary object of the trust itself, and still get exemptions within section 4(3)(i) of the Act of 1922. The relevant section provided that:

> "4(3) Any income, profits or gains falling within the following classes shall not be included in the total income of the person receiving them:-
>
> (1) ... Any income derived from property held under trust or other legal obligation wholly for religious or charitable purposes, and in the case of property so held in part only for such purposes, the income applied, or finally set apart for application thereto."

In this case a trust known as J.K. Trust, Bombay, purchased the 'controlling interest' in the Raymond Woollen Mills for a period of 20 years from September 3rd, 1945, and the trustees who were appointed as 'managing agents', were to get a commission of 10 per cent of the amount of the annual profit of the company, subject to a minimum of Rs. 50,000 per annum and an office allowance of Rs. 1,000 per month.

It was held that the income derived from the agency business, i.e. the commission earned by the trustees as 'managing agents', was income of the trust and was, therefore, exempt from taxation, under section 4(3)(i) of the Act of 1922.

It is submitted, with respect, that their Lordships misconstrued the provisions of the section in question . The exemption under section 4 (3) (i) was perhaps conferred upon income, which was derived from property settled upon a charitable trust. The mere creation of a trust of future income was not sufficient to justify exemption from taxation. In fact, the managing agency commission was neither derived from the trust fund, nor was the trust fund invested in the managing agency. Managing agency commission was paid to the trustees for the work they did as managing agents, and therefore, only after the tax was deducted, did an obligation fall on the trustees to invest the amount for the purposes of the trust.

Similarly, the Supreme Court held, in Trustees of the Charity Fund v. C.I.T., Bombay[5], that the income of a trust created for giving education, medical help and monetary relief to the poor is exempt from taxation, under section 4(3)(i) of the Act of 1922, even though the entire income was spent on the relations of the donor.

It is submitted, with respect, as pointed out by the High Court of Bombay[6], this was a fairly blatant illustration of a settler trying to benefit his own family and his own relations, and that the benefit to the public was too remote and too illusory to come under section 4(3)(i) of the Act. In fact, income from a business can only be exempt from taxation, if the business is done in the course of the actual carrying out of the primary purpose of the institution, and, in the present case the business was not being carried on in the course of carrying out

---

5. A.I.R. 1959 S.C. 1060 = (1959) 36 I.T.R. 513 (S.C.).
6. Trustees of Gordhandas Govindran Family Charitable Trust v. C.I.T. (Central) Bombay, A.I.R. 1952, Bom. 346.

the primary object of the trust, so the income could not be exempt from taxation.

The legislature, by Act of 25 of 1953, added a new proviso (b) to sub-clause (i) of section 4 (3) of the Act, to nullify the effect of the Supreme Court's decision on the point and to ensure that the income of religious and charitable institutions arising from a business was only exempt from taxes, if the business was carried on behalf of such charitable institutions. The proviso (b) to S. 4(3)(i) says:

> "..[I]n the case of income derived from business carried on, on behalf of a religious or charitable institution, unless the income is applied wholly for the purposes of the institution and either -
> (i) the business is carried on in the course of the actual carrying out of a primary purpose of the institution, or
> (ii) the work in connection with the business is mainly carried on by beneficiaries of the institution.

Nevertheless, the Bombay High Court in Dharm Vijay Agency, Bombay v. C.I.T., Bombay[7], held that, where a business is carried on under a trust, the income of such a trust would be exempt from tax, in spite of the non-fulfilment of the conditions laid down in the proviso (b) to section 4(3)(i) of the Act.

In Jogendra Nath Naskar v. C.I.T., Calcutta,[8] an interesting question arose before the Supreme Court as to whether a Hindu deity could be assessed to income tax through the

---

7. A.I.R. 1960 Bom. 380.
8. A.I.R. 1969 S.C. 1089; see supra note 46(vii) at pp. 338-390.

shebait (manager) as a unit of assessment under sections 3 and 4 of the Income Tax Act of 1922. The facts found are as follows. This was a family private religious endowment. One Ram Kristo Naskar left by a will dated May 17, 1899, certain properties as debutter to two deities and appointed his two sons as the shebaits. Elaborate provisions were made as to the manner in which the income from the property was to be spent.

The Income-tax Officer initiated proceedings for the assessment of income from the property held by the deities in question against the shebaits of the two deities and completed the assessment on the deities as if they were human individuals. The relevant assessment years in question were 1952-53 and 1953-54.

The appellant objected to the assessment. His main contention was that the deity was not chargeable to tax under section 3 of the Act of 1922 and that deity was not 'individual' within the meaning of the Act and so it could not be taxed .

Their Lordships rightly brushed aside the appellants contention and held that:

> "...The Hindu idol is a juristic entity capable of holding property and of being taxed through its shebaits, who are entrusted with the possession and management of its property."[9]

---

9. Ibid. at p. 1093 (para 7); See Pran Krishan Das v. Controller of Estate Duty, A.I.R. 1968 Cal.496.

The Court refused to give a restricted meaning to the word 'individual' so as to limit it to human beings. They said that the word was capable of a wide and comprehensive meaning and included juristic persons, corporations and so on. This decision is not open to criticism.

Tax Avoidance Legislation

Tax avoidance legislations may broadly be classified into specific and general anti-avoidance provisions[10]. The first type of legislation is directed against particular types of avoidance transaction, whereas the second aims at

---

10. See 'Company Taxation in Nigeria' by Agboola (Ph.D. thesis, University of London, 1968), at pp.214 to 233; 'Some Problems of Evasion and Avoidance of Income Tax in Israeli Law compared with Similar Problems in English Law, by Arie Lepidoth (Ph.D thesis, University of London, 1964,) Chapter 22; supra note 15 at pp. 553 to 573. The Royal Commission has classified anti-avoidance legislation into four categories, viz., (1) 'Sniper' approach (specific provision), (2) 'Shotgun' approach (general provision), (3) 'transactions not at arm's length (parties to particular types of transactions not following the same type of trade, i.e., when one is a grocer and the other is a steel manufacturer and they enter into business transactions) and (4) 'administrative control' approach; supra note 4 at p.225. Professor Wheatcroft has classified such legislation into five categories, viz., (1) The "patching" method; (2) The "hit-or-miss" method; (3) the use of prior department consent; (4) making the law too wide and relying on the good sense of the Inland Revenue; and (5) retrospective legislation.

preventing tax avoidance in general[11]. In India as in the United Kingdom[12], the legislature has preferred to enact the first type of legislation rather than the second. In other words, specific provisions which identify with precision the kind of transaction that is to be attacked has been enacted to invalidate the particular type of tax avoidance device resorted to by the ingenious taxpayer[13].

Some of the anti-avoidance provisions in the Income Tax Act of 1961[14] are in Chapter 10 and others are outside it. Truly speaking, there is no difference between the two kinds of provisions; both aim at hitting transactions made with a view to avoid tax liability. The difference between the two is in the arrangement of the provisions in the statute. On the one hand, the legislature has enacted a separate chapter entitled: 'Special provisions relating to avoidance of tax; dealing with some of the more important forms of tax avoidance', prevalent in India. On the other

---

11. The legislature in most of the countries prefer to enact the first type of legislations only. However, during recent years, some countries have made provisions of a general type to combat large scale tax avoidance. See <u>infra</u> p. 126 for a list of the countries.
12. Income and Corporation Taxes Act (1970 c 10) includes comprehensive provision in 37 sections (460-496).
13. '<u>Final Report of the Royal Commission on Taxation of Profits and Income</u>' (1955), Cmd. 9474, s. 1020, p. 306, has advocated specific legislation to combat tax avoidance.
14. The Income Tax Act, 1922, had no separate chapter dealing with tax avoidance. The provisions were scattered all over the Act.

hand, the legislature has plugged loopholes in the law, by enacting specific provisions in the Act, wherever it thought fit.

In the first category, special measures have been taken to foil the attempt of taxpayers to avoid taxes by directing that no effect shall be given to transactions entered into for the purpose of avoiding income tax. For instance, sections 92 to 94 provide that one's liability to pay tax is not reduced and cannot be ignored, for tax purposes,

(i) where business is so arranged between a resident and a non-resident that the business transacted produces to the resident either no profit or less than the ordinary expected profit[15], or

(ii) where a transfer of assets is affected in such a manner that the income becomes payable to a person not resident or not ordinarily resident in India, thus making income-tax provisions inapplicable, whereas, in fact, the transferor enjoys such income, whether forthwith or in the future[16], and

(iii) where shares and securities, or securities cum interest and shares cum dividend are sold under an

---

15. See Chapter 4, p.187 for section 42(2) of the Act of 1922, which was the corresponding section 92 of the present Act of 1961.
16. See Chapter 4, p.189 for section 44D of the Act of 1922, corresponding to section 93 of the Act of 1961.

agreement to buy back, a transaction known as bond-washing, avoiding liability in respect of the interest or dividend[17].

The second category covers cases in which taxpayers attempt to reduce the incidence of tax, either by transferring assets to a third party, or to his spouse or minor child[18], or by admitting the spouse as a partner or by admitting a minor child to the benefits of partnership in a firm in which the taxpayer is a partner[19], or by purchasing property in the name of the other, a benami transaction[20], is foiled. In such cases the transferor is deemed to be the assessee for income-tax purposes, though he may not be the recipient of the income in strict terms of the law, and he is made liable to pay the tax due on the income of the transferee. In certain cases mentioned under section 9 of the Act of 1961[21], certain income accruing to an assessee abroad is deemed to accrue in India and is included in the assessee's income for tax purposes.

---

17. Income Tax Act, 1961, section 94 is corresponding to section 44E and 44F of the Act of 1922. See supra p.86 for meaning of bond-washing.
18. Income Tax Act, 1961, Ss 61 to 63 (= I.T.A., 1922, s.16(1).
19. Income Tax Act, 1961, S. 64 (= I.T.A., 1922, s. 16(3).
20. Income Tax Act, 1961, S. 143 (= I.T.A., 1922, s.23(3).
21. See Chapter 4, p. 187 for the text of section 42(1) of the Act of 1922, which was the corresponding provision to section 9 of the Act of 1961.

The Act of 1961, as a precautionary measure, has also provided for the assessment of income of those persons who are leaving India during the current assessment year[22], or where a person is likely to alienate or dispose of assets with a view to avoiding payment of any liability under the Act[23], or where any business or profession is dissolved or discontinued during the current accounting year; the tax is assessed in that very year[24].

The legislature has also imposed certain statutory obligations on the part of the persons responsible for disbursing dividends[25], interest[26](other than interest on securities), salaries[27], contractors[28], liquidators of a company which is being wound up[29], and the directors of a private company in liquidation[30] to supply the necessary information as required under the relevant provisions of the Act, to the appropriate Income-tax Officer, in order to help detection of any avoidance of tax[31]. Failure to furnish such information without reasonable cause in the

---

22. Income Tax Act, 1961, section 174.
23. " " " " " 175.
24. " " " " " 176.
25. " " " " " 286.
26, " " " " " 285
27. " " " " " 206.
28. " " " " " 285A.
29. " " " " " 178.
30. " " " " " 179.
31. 'Law and Practice of Income Tax' by J.B. Kanga and N.A. Palkhiwala, 6th ed., vol I., (1969), p. 917.

first three cases is punishable with a fine which may extend to Rs. 10 for each day of default under section 276[32] and making a deliberately false return is punishable under section 277[33] with imprisonment which may extend to six months. Defaulting contractors are punishable under section 285A of the Act and in other cases appropriate sanctions have been provided[34].

Thus the legislature in India appears to be well aware of the problem relating to tax avoidance and has endeavoured from time to time to plug the loopholes in the law as well as to introduce new provisions. But it must be a long time before real success in combating tax avoidance will be achieved.

It can be appreciated, from the decisions of the Courts in cases relating to tax avoidance[35], that the law must be much stricter, if the taxpayer's attempts to avoid payment of taxes are to be frustrated as far as possible. The legislature should review the decisions of the courts on the point regularly and make suitable amendments, but hasty and half-hearted legislations should be avoided.

---

32. See Chapter 7, pp.353.
33. See Chapter 7, pp.398-99
34. See Chapter 7.
35. See Chapter 4 for Judicial Attitude to Tax Avoidance.

It would be appropriate to suggest at this stage that a new section of a general nature, on the lines of section 260 of the Australian Income-tax and Social Service Contribution Assessment Act, 1936-70 should be enacted. This is necessary in view of the fact that under the present provisions a tax avoidance transaction can only be dealt with, if it comes within one of the provisions enacted, with the result that a large number of tax-avoiders succeed. Obviously, no legislature can forsee all possible methods of tax avoidance, but there must be some provisions to deal with undesirable elements. It may be argued that the wide power given to the revenue authorities might be used to exploit innocent taxpayers. To prevent that, appropriate measures can be taken. An official of the rank of Commissioner of Income-tax only might be empowered to initiate proceedings[36]. Moreover, such a general provision is functioning well in New Zealand[37],

---

36. In Canada sub-section (1) of s. 138 empowers the Treasury Board to set aside a perfectly legal transaction for tax purposes, if it is convinced on reasonable grounds that the main purposes for a transaction or transactions was improper avoidance or reduction of taxes. See 'Canadian Income Tax: A Treatise on the Income Tax Law of Canada' (1970), Butterworth, pp.2851, 2852.
37. Income Tax Act, 1954, section 108.

Canada[38], South Africa[39], Nigeria[40], Ghana[41], Sierra Leone[42], Gambia[43] and The Netherlands[44], and there is a feeling in other places that such legislation is more effective in checking tax avoidance[45].

Section 260 of the Australian Income Tax and Social Service Contribution Assessment Act, 1936-1970 runs as follows:

> "Every contract, agreement, or arrangement made or entered into, orally or in writing, whether before or after the commencement of this Act, shall, so far as it has or purports to have the purpose or effect of in any way, directly or indirectly -
> (a) altering the incidence of any income tax,
> (b) relieving any person from liability to pay any income tax or make any return.
> (c) defeating, evading, or avoiding any duty or liability imposed on any person by this Act: or
> (d) preventing the operation of this Act in any respect,
> be absolutely void, as against the Commissioners, or in regard to any proceeding under this Act, but without prejudice to such validity as it may have in any other respect or for any other purpose".

---

38. Income Tax Act (RSC) 1952, c 148 as amended sec. 138.
39. Income Tax Act, 1962, section 103.
40. Companies Income Tax Act, 1961, section 25.
41. Income Tax Ordinance (27 of 1943) section 17.
42. Income Tax Ordinance (1 of 1943) section 19.
43. Income Tax Ordiance (26 of 1948) section 16.
44. Article 1 of The Netherlands Laws (29th April, 1925) Quoted from <u>supra</u> note 15, at pp. 571,572.
45. <u>Supra</u> note 4 at pp. 228 to 230. Professor Wheatcroft advocates for such a provision in British Income Tax. See '<u>Tax Reform Proposal in New Zealand</u>' by J.H. Jenkins (1968) Canadian Tax Journal, p. 151.

CHAPTER IV

JUDICIAL ATTITUDE TO TAX AVOIDANCE

Construction of Taxing Statutes

A statute is nothing but the 'will of the legislature'[1]. The task of the judiciary is to give effect to the intention of Parliament from the actual words of the statute[2], because it is the words that speak the intention of the legislature[3]. In other words, the role of a judge is jus dicere not jus dare, i.e., words of a statute must not be over-ruled by the judges and reform, if any, must be left to Parliament[4].

Taxing statutes, like any other statute[5], are construed strictly and effect is given to the letter of the law, according to the plain and ordinary meaning of the language used, irrespective of the spirit or intention of

1. Maxwell on the Interpretation of Statutes, 12th edition, 1969, at p.1.
2. Ibid; Report of the Royal Commission on taxation, Canada, (1966), Vol.3. at p.543, Bradbury v. Enfield London Borough Council, (1967,) 1, W.L.R. 1311 per Diplock, L.J. at p. 1334.
3. Warburton v. Loveland (1832) 2 D. & Cl. 480, per Tindal C.J. at p. 489. Quoted from (1901) 4 English Reports, p. 806.
4. Cheney v. Conn (1968) 1 W.L.R. 242; Eastwood v. Henod (1968) 2 Q.B.D. 932.
5. 'Odger's Construction of Deeds and Statutes', Gerald Dworkin (1967), p. 464; Attorney-General v. Carlton Bank (1899) 2.,Q.B.D., p.158 per Lord Russell C.J. (Quoted) Styles v. Middle Temple, 4 tax cases,123 per Wills J.

the legislature, which prompted it to enact such provisions[6]. The burden of proof that any case falls within a taxing statute is on the Revenue[7] and the benefit of doubt, if any goes in favour of the taxpayer[8]. The rule of construction of taxing statutes may be explained well by a frequently quoted passage of Lord Cairns in Charles James Partington v. Attorney General. Lord Cairns says:

> "...The principle of all fiscal legislation, it is this: If the person sought to be taxed comes within the letter of the law he must be taxed, however great the hardship may appear to the judicial mind to be. On the other hand, if the Crown, seeking to recover the tax, cannot bring the subject within the letter of the law, the subject is free, however apparently within the spirit of the law the case might otherwise appear to be. In other words, if there be admissible, in any statute, what is called an equitable construction, certainly such a construction is not admissible in a taxing statute, where you can simply adhere to the words of the statute."[9]

Further Lord Cairns, the propounder of the rule of strict construction of statutes, explains the basis of such a principle in Pryce v. Monmouthshire Canal and Railway Companies in the following words:

---

6. Report of the Royal Commission on Taxation : Canada, 1966, Vol. 3 at p.543.
7. The Construction of Taxing Statutes, Gerald D. Sangan, (1940), Vol. 18; The Canadian Bar Review, p.43 at p.45; Adamson v. Attorney-General (1933) A.C. 257; Russell v. Scott (1948) A.C. 422 at p. 433; see Chapter 8 pp.471-84, Lakshmiratan Cotton Mills v. C.I.T. U.P., A.I.R. 1969 S.C. 917.
8. Escorts (Agents) Private Ltd. v. C.I.T., A.I.R. 1959 Raj. 364,366; Hegde J. In C.I.T. Punjab v. Kulu Valley Transport Co. Ltd., A.I.R. 1970 S.C. 1734, said at p. 1741, that:
   "If two views are possible, the view which is favourable to the assessee must be accepted while construing the provisions of a taxing statute."
9. (1869) 4 L.R. 100, 122. (H.L.).

"The cases which have decided that taxing Acts are to be construed with strictness, and that no payment is to be exacted from the subject, which is not clearly and unequivocably required by the Act of Parliament to be made, probably meant little more than this, that inasmuch as there was no a priori liability in a subject to pay any particular tax, nor any antecedent relationship between the taxpayer and the taxing authority, no reasoning founded upon any supposed relationship of the taxpayer and the taxing authority could be brought to bear upon the construction of the Act, and therefore the taxpayer had a right to stand upon a literal construction of the words used, whatever might be the consequences."[10]

Perhaps the rule of strict construction of statutes originated in the apathy of the judiciary towards unmeritorious defences to civil actions, relating to stamp duties, and it emerged as a rule that the onus was on the Crown to show clearly that the case fell within the statute[11]. Thus it is a well established rule of law that a tax must be imposed in clear and unambiguous language[12], and that the language must not be strained in order to tax a transaction, which had not been covered by appropriate words by the legislature[13].

The principle of strict construction has been followed in the United Kingdom since the very inception of taxing statutes and from that time the judiciary has reaffirmed its unqualified approval of the century old

10. (1879) 4 A.C. 197 at pp. 202,203.
11. The Attitude of the Legislature and the Courts to Tax Avoidance, Wheatcroft, G.S.A. (1955) 18, The Modern Law Review, p. 209 at p. 215.
12. 'Introduction to Income Tax Law - Canada', Francis Eugena Law Brie (1955), pp. 359,360.
13. Supra note 1 at p.256.

established principle[14]. However, in case of ambiguity in statutory provisions, the courts might reject the strict literal approach and apply the Golden Rule[15] to carry out the general intention of legislature[16].

---

14. Rowlatt J. in Cape Brandy Syndicate v. I.R.C. said: "In a taxing Act one has to look merely at what is clearly said. There is no room for any intendment. There is no equity about a tax. There is no presumption about a tax. Nothing is to be read in, nothing is to be implied. One can only look fairly at the language used." (1921) 1 K.B. 64 at p.71; approved in Canadian Eagle Oil v. R (1946) A.C. 119 at p. 140 per Lord Simon; Dewar v. I.R.C. (1935) 2 K.B. 351 at p.360 per Lord Hanworth M.R.; I.R.C. v. Wolfson (1949) 1 All E.R. 865 at p.868 per Lord Simonds; I.R.C. v. Hinchy (1960) A.C. 748 at p.766 per Lord Reid; I.R.C. v. Clifforia Investment Ltd. (1963) 1 W.L.R. 396.
15. The Rule was enunciated by Lord Wensley in Grey v. Pearson in 1857. The Rule is as follows: "In construing wills and indeed statutes and all written instruments, the grammatical and ordinary sense of the words is to be adhered to, unless that would lead to some absurdity, or some repugnancy or inconsitency with the rest of the instrument, in which case the grammatical and ordinary sense of the words may be modified so as to avoid that absurdity and inconsistency, but no further." (1857) 6 H.L.C. 61 at p. 106; Cf Pakala Narayan Swami v. King-Emperor (1939) 66 Ind. App. 66 at p. 78.
16. The House of Lords applied the Golden Rule in place of strict interpretation in I.R.C. v. Luke (1960) 40 T.C. 630. Their Lordships said at p.646 and 648 (per Lord Reid): "To apply the words literally is to defeat the obvious intention of the legislation and to produce a wholly unreasonable result; we must do some violence to the words.... In order to avoid imputing to Parliament an intention to produce an unreasonable result, we are entitled and indeed bound to discard the ordinary meaning of any provision and adopt some other possible meaning, which will avoid that provision."

It becomes apparent from the analysis of cases decided by the Courts in countries like India[17], Canada[18], Australia[19], Israel[20] and South Africa[21], which are influenced by the Common law system that the principle of strict construction of statutes is applied as in the United Kingdom. For instance, the Supreme Court of India said in C.A. Abraham v. I.T.O., Kottayam that:

> "In interpreting a fiscal statute the court cannot proceed to make good deficiences, if there be any; the court must interpret the statute as it stands and, in case of doubt, in a manner favourable to the taxpayer."[22]

---

17. C.A. Abraham v. I.T.O., Kottayam and another, A.I.R. 1961 S.C. 609 at p. 612; Phra Phraison Salarak v. C.I.T. 3 I.T.C. 237, 243; Hari Krishna Das v. C.I.T. 5 I.T.C. 275, 278; Behari Lal Bhargava v. C.I.T. 1941 I.T.R. 24; Charitable Gadodia Swadeshi Stores v. C.I.T. 1944 I.T.R. 385, 391; Gappumal Kanhaiyalal v. C.I.T. 1945 I.T.R. 210, 221; affirmed by S.C. 1950 I.T.R. 584; Maharaja of Kapurthala v. C.I.T. 1945 I.T.R. 74, 93; Upper India Chamber of Commerce v. C.I.T. 1947 I.T.R. 263, 281; Pragdas Mathura Das v. I.T.O. 1950 I.T.R. 757, 761; Ambika Silk Mills Co. Ltd., v. C.I.T., Bombay (1952) 22 I.T.R. 58, 64.
18. M.N.R. v. Maclnes (1954)(Ex.C.R. 181;) See 'Canadian Income Tax: A Treatise on the Income Tax Law of Canada, (1970), at p. 2833.
19. Legislation Against Tax Avoidance: The Australian Experience, H.A.J. Ford, (1961), pp. 247 and 248.
20. C.A. 120/52, Kome Rovski v. Director of Land Betterment Tax, 7 Piskein Din 141, at p. 153. Quoted from Arie Lepidoth's Ph.D thesis (University of London - 1964) at p. 224.
21. Tatem Steam Navigation Co. Ltd. v. C.I.R. (1941) 2 A.E.R. 111; see 'Silke on South African Income Tax, 5th ed. 1967) Jute & Co. Ltd., p. 858.
22. A.I.R. 1961 S.C. 609, 612. (para 6).

The rule of strict construction does not appear to have been invoked in the United States of America, where a more equitable construction is applied[23].

There appears to be a problem area in the field of taxation statutes, in regard to cases where ingenious devices have been innovated by taxpayers, to defeat the very object of the legislature by reducing or avoiding tax. It would not only be of academic interest but of administrative and sociological interest as well to discuss, in brief, the attitude of the courts towards such cases and to note how far the judiciary has stretched the wording of a statute to cover such types of cases.

It is, therefore, proposed to discuss in brief the views propounded by the highest courts of law in this area of taxing statutes in the United Kingdom and India respectively.

Traditional Approach in the United Kingdom

The judicial trend in the United Kingdom towards tax avoidance legislation, has been, ever since the beginning of such provisions, to construe statutes literally and to determine tax liability, according to strict legal canons. That is to say, the courts take the words of the Statute as it is and apply them to the facts of the particular case,

---

23. See supra note 11, at p. 215; Gregory v. Helvering (1934) 69 F. 2nd. 809, 811 affirmed by the Supreme Court of the U.S. in (1935) 293 U.S. 465.

irrespective of the intention of the legislature[24] or the financial or economic effect of the decision. This rule may be described as the rule of the legal effect or result[25]. In other words, the language of the statute is not to be stretched either in favour of the State[26] or narrowed down in favour of the taxpayers[27]. As a result the courts have invariably upheld the rights of a man so to arrange his affairs as to attract the least amount of taxes, by making use of the loopholes in the law and by adopting ingeneous devices. This attitude of the judiciary could be noted as early as 1889, when Lord Esher M.R. made the following statement in Commissioner of Inland Revenue v. Angus and Co.:

> "The Crown ... must make out its right to the duty, and if there be a means of evading the duty, so much the better for those who can evade it. It is no fraud upon the Crown, it is a thing which they

---

24. Supra note 11 at p. 214.
25. Supra note 6 at p. 546.
26. Supra note 1 at p. 141; C.H.W. (Huddersfield) Ltd. v. I.R.C. (1963) 1 W.L.R. 767; I.R.C. v. Coutts and Co., 1964 A.C. 1393; W.M. Cory and Sons Ltd. v. I.R.C. (1965) A.C.. 1088.
27. De Vigier v. I.R.C. (1964) 1 W.L.R. 1073; Ridge Nominees Ltd. v. I.R.C. (1962) Ch 376 and Westward Television v. Hart (Inspector of Taxes) (1968) 3 W.L.R. 480.

are perfectly entitled to do."[28]

May be, the judiciary in Britain has failed to act as an independent umpire and has gone beyond its cherished role of impartial referee in deciding tax avoidance cases. Courts have not only vehemently opposed the idea of morality in tax avoidance cases, but have gone to the extent of encouraging the idea that there is nothing wrong, either legally or morally, in the well-to-do reducing their tax liability within the four corners of the law[29]. For instance, Lord Clyde, Lord President of the Court of Session, emphatically said in Ayrshire Pullman Motor Services v. I.R.C.:

---

28. (1889) 23 Q.B. 579 at p. 593. Similar statements can be found in a number of cases. For instance, Lord Sumner stated in Commissioner of Inland Revenue v. Fisher's Executors (1926) 10 Tax Cases 302 at p. 340 that: "My Lords, the highest authorities have always recognized that the subject is entitled so to arrange his affairs as not to attract taxes imposed by the Crown so far as he can do so within the law, and that he may legitimately claim the advantage of any express terms or of any omissions that he can find in his favour in Taxing Acts. In so doing, he neither comes under liability nor incurs blame." Some of the other cases in which similar propositions have been made are as follows: Attorney-General v. Duke of Richmond and Gordon, (1908) 2 K.B. 729 at p. 743 per Farwell, L.J.; S.W. Hawker v. J. Compton (1922) 8 Tax Cases 306 at p. 313 per Sankey J.; Dickinson v. Gross (1927) 11 Tax Cases 614 at p. 620 per Rowlatt, J.; Linton v. Chapman, (1928 13 Tax Cases 448 at p. 454 per Lord Clyde; Commissioner of Stamp Duties v. Byrnes (1911) A.C. 386 at p. 392 per Lord Macnaghten.
29. 'Evasion of Income Tax', A.F. (1941) L.Q.R. Vol.57 at 458.

"No man in this country is under the smallest obligation, moral or other, so to arrange his legal relations to his business or to his property as to enable the Inland Revenue to put the largest possible shovel into his stores. The Inland Revenue is not slow - - and quite rightly - - to take every advantage, which is open to it under the taxing statute, for the purpose of depleting the taxpayer's pocket. And the taxpayer is, in like manner, entitled to be astute to prevent, so far as he honestly can, the depletion of his means by the Revenue."[30]

Similarly, the courts have dispelled the idea of looking at the 'substance' of the transaction as opposed to the 'form' in order to arrive at a decision in such cases. For instance, in the leading case of C.I.R. v. Duke of Westminster, their Lordships of the House of Lords upheld a scheme to mitigate tax, by which the former Duke of Westminster reduced his surtax liability, by paying a portion of his servant's wages in the form of a legally binding annuity. The payments under the Deed were, in substance, payments of remuneration to the servants and so not deductible in computing surtax. Their Lordships, once again, affirmed that a strict construction is applied to both the wording of the statute and the form in which the taxpayer has clothed his action. Lord Tomlin stated the principle of law in the following words:

"Every man is entitled, if he can, to order his affairs so as that the tax attaching under the appropriate Acts is less than it otherwise would

30. (1928-29) 14 T.C. 754 at pp. 763, 764; D.M. Ritche v. Commr. of I.R. Levene v. C.I.R. (1928) A.C. 217 at p. 227. per Lord Sumner.

be. If he succeeds in ordering them, so as to secure this result, then, however unappreciative the Commissioners of the Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax. This so-called doctrine of 'the substance' seems to me to be nothing more than an attempt to make a man pay notwithstanding that he has so ordered his affairs that the amount of tax sought from him is not legally claimable."[31]

Tax Avoidance Cases

During the beginning of the last decade of the mid-twentieth century, a welcome change in the attitude of the judiciary towards tax avoidance cases is discernible. Perhaps the swing of the pendulum of the courts' attitude towards such cases, from a somewhat unconscious admiration to a growing recognition of its social impropriety, may be due to the crisis of the Second World War.[32]

The dawn of social consciousness on the part of the judiciary towards the civic vice of "legal evasion" can be found in the judgement of Lord Green in the case of Lord Howard de Walden v.C.I.R.[33] In this case for the first time it

31.(1936) A.C.I. pp. 19-20.
32.'Prevention of Legal Evasion' (1945) 61, L.Q.R. at p.228; 'Evasion of Tax',A.F. (1942) 58, L.Q.R. at p.168.
33.(1942 1 K.B.389. Lord Green M.R., while construing an anti-avoidance section said: "The section is a penal one, and, its consequences, whatever they may be, are intended to be an effective deterrent which will put a stop to practices which the legislature considers to be against the public interest. For years a battle of manoeuvre has been waged between the legislature and those who are minded to throw the burden of taxation off their own shoulders on to those of their fellow-subjects. In that battle, the legislature has often been worsted by the skill, determination and resourcefulness of its opponents,of whom the present appellant has not been the least successful. It would not shock us in the least to find that the legislature has determined to put an end to the struggle by imposing the severest of penalties. It scarcely lies in the mouth of the taxpayer, who plays with fire to complain of burnt fingers." (p.397).

was recognized by the courts that the Crown stood for the taxpayers as a whole and not for the greedy Revenue.

The judicial attitude becomes more apparent and crystal clear in Latila v. I.R.C.[34] In this case their Lordships frustrated the appellant's attempt to avoid British income-tax and super-tax by artificial devices. The Court's view cannot be better exemplified than by quoting verbatim from the Lord Chancellor Viscount Simon's remarks in the case. He said:

---

34. (1943) A.C. 377 (H.L.)=(1943) 1 All E.R. 265. The appellant and three other ladies, residents of the U.K., sold their 2/3rd shares in a partnership firm called John Mock and Company in Rhodesia to a company known as Latjohn Trust Ltd. as from April 1, 1932, the date on which the company was registered. The company issued 10,000 shares and 250,000 debentures for £1 each to the ladies, as consideration for the said transfer. The debentures carried no interest, and there was no provision as to the period of redemption. The business was making a good profit, but it never declared a dividend. The company used to apply its profit in redeeming debentures. The appellant, along with the other three ladies, used to borrow money from the company, in anticipation of the debentures which they had. Thus they used to get a share in the profits of partnership business, through the Latjohn Trust Ltd., without incurring any liability to pay tax. In other words, the redemption was a means for transferring part of the profits (of the firm) to these ladies in the form of capital. Their Lordships rightly rejected the appellant's contention that the share of profits to which the Latjohn Trust Ltd. became entitled could not be described as income under section 18 (1) of the F.A., 1936; Congreve v. Inland Revenue Commissioners, (1948) L.T.R., p. 1229.

"My Lords, of recent years much ingenuity has been expended in certain quarters in attempting to devise methods of disposition of income, by which those who were prepared to adopt them might enjoy the benefits of residence in this country while receiving the equivalent of such income, without sharing in the appropriate burden of British taxation. Judicial dicta may be cited which point out that, however elaborate and artificial such methods may be, those who adopt them are "entitled" to do so. There is of course, no doubt that they are within their legal rights, but that is no reason why their efforts, or those of the professional gentlemen who assist them in the matter, should be regarded as a commendable exercise of ingenuity or as a discharge of the duties of good citizenship. On the contrary, one result of such methods, if they succeed, is, of course, to increase pro tanto the load of tax on the shoulders of the great body of good citizens, who do not desire, or do not know how, to adopt these manoeuvres."[35]

The Courts went a step further in exercising their inherent or statutory power to approve or disapprove of a legal transaction, involving tax avoidance[36]. For instance, in re A. and D. Fraser Ltd.[37], the Court of Session rejected a petition by the company for reduction of capital, on the plea of 'public policy', because the sole object of the transaction was to enable the shareholders to avoid taxation. Lord Keith said that the Courts should not be made an instrument for tax avoidance, even when the method proposed might be within the law. Lord Carmant made even more forceful comment. He said:

---

35. Ibid at p. 381 (A.C.
36. Supra note 11 at p. 218; Re Drages Ltd. (1942) 1 All Eng. Rep. 194; Re Basden's Settlement (1942) 2 All E.R.
37. (1951) Sc. L.T. 273.

> "I think also that the question whether public policy demands that the Judicature should be kept in every way clear of association with transactions, which, in their best aspect, are such as are not resorted to by the good citizen, is one which ought to be considered and acted on. The confirmation by the court is, in public estimation, the approval of the court and even in doubtful transactions, it ought not to be given. Much more so when a transaction is redolent of tax evasion as its sole object. In the present case... the whole transaction is for an oblique and illegitimate purpose; it is not for the benefit of the company but to enable individual shareholders to escape taxation."[38]

Another remarkable shift in the attitude of judiciary can be noted in regard to provisions for payment of tax, subject to a proviso. For instance, in Carbett's Executors v. I.R.[39], their Lordships held that, in order to claim the benefit of the proviso of section 18 of the Finance Act, 1936[40], a taxpayer must prove to the satisfaction of the Revenue that the transaction was effected " mainly for some purpose other than of avoiding liability to taxation". In other words, the burden of proof that the transaction is outside the scope of the section is on one, who wants to

---

38. Ibid at p.277 However, since the decision of the House of Lords in re. Westburn Sugar Refineries, Ltd., (1951), A.C. 625, that the approval of a reduction of Capital, which was entered into to evade the Nationalization proposals, ought not to be refused, the Court of Session has reversed its practices. Now it does not treat tax avoidance as a ground for refusal of a reduction of capital. Re Davis Bell, Ltd., 1954 S.C. 33. Quoted from supra note 11 at p. 219; Firestone Tyre and Rubber Co. v. Llewellin, (1957) 1 W.L.R. 464.
39. (1943) 2 All E.R. 218.
40. Sec.18, of F.A. 1936 was aimed at those cases where liability to income tax was avoided by means of transfers and other arrangements, of assets out of U.K. Similar view has been taken by the Court of Chancery in I.R.C. v. Brown (1971) 1 W.L.R. 11.

enjoy its benefits. The Crown need not establish that the main purpose of the transaction was the avoidance of taxation[41].

In an interesting case, Re Emery's Investment Trusts[42], the court refused relief to a husband on the principle of equity ex turoi causa non oritur actio[43], i.e., an action does not arise from a base cause.

The appellant, Emery, a British resident abroad, invested some money out of a joint account in the names of husband and wife, held by a bank in New York in the common stock of American companies in the sole name of his wife, though the parties intended that the beneficial interests in the stock should belong to them equally. This was done merely to avoid American Withholding Tax of 30 per cent on the dividends on the stock. If the investment had been made in the husband's name, or if his beneficial interest had been known, the dividend would have been subject to the Withholding Tax, because husband was an alien resident in the United States. Later on, the stock was sold by Mrs. Emery, and Mr. Emery brought an action, claiming that he was entitled to a half interest in the sale.

41.'Legal Evasion of Taxation', A. Farnsworth, (1944), Modern Law Review, p.84.
42. (1959) 2, W.L.R. 461.
43, Similar to Ex dolo malo nor oritur actio:from fraud a right of action does not arise. A court of law will not lend its aid to enforce the performance of a contract, which appears to have been entered into by both the contracting parties for the express purpose of carrying into effect what is prohibited by the law of the land, or is founded upon an immoral consideration.

Wynn-Parry, J., held that Mr. Emery could not claim any relief, because, if two persons knowingly violate the laws of a country, they can not ask the court to assist them by enforcing such agreements. The investment of money in the name of the wife raised a presumption of advancement in the wife's favour. To rebut such presumption the husband was bound to affirm the true facts, viz., that there was an agreement improperly to avoid payment of taxes. And once it was established that the husband had come before the courts with unclean hands, he was not entitled to any relief[44].

---

44. See "More About Unclean Hands", Leolin Price, (1959) B.T.R. 449 and 229.
In an earlier Canadian case, Coplan v. Coplan (1958) 14 D.L.R. (2d) 426, the principle of unclean hands was not applied. The affairs of the company, with a view to avoiding income tax were so arranged, that it might look like a 'personal corporation' and not a 'commercial operation'. A, transferred shares to B and B was registered as their owner, though B was never intended to have any beneficial ownership in the shares. Accordingly, B executed a blank transfer of shares with a certificate that *prima facie* entitled A to be registered as owner of the shares, but as the object of the transaction was to make it appear that B was their owner, A was never registered. In an action by A's executors for a declaration that they were entitled to be registered as owners of the shares, the Ontario Court of Appeal allowed their claim. The court relied on the blank transfers and reversed the trial court's judgement, in which the executors' claim was rejected on the principle of *ex turpi causa non oritur actio*.

Lord Denning, L.J., in Seaford Court Estates Ltd., v. Asher, explains the role of a judge in interpretation of a taxing statute in the following words:

> "...[W]hen a defect appears, a judge cannot simply fold his hands and blame the draftsman. He must set to work on the constructive task of finding the intention of Parliament, and he must do this, not only from the language of the statute, but also from a consideration of the social conditions which gave rise to it, and of the mischief which it was passed to remedy, and then he must supplement the written word, so as to give 'force and life' to the intnetion of the legislature."[45]

But, it would appear that, after the close of the war, the tide turned again and there has been a trend in the reverse direction[46]. The orthodox principle of 'strict construction' and of 'form' still holds good. For instance, in Vestey's Executors v. I.R.C., Lord Normand said:

> "Parliament, in its attempt to keep pace with the the ingenuity devoted to tax avoidance, may fail short of its purpose. That is a misfortune for the taxpayers, who do not try to avoid their share of the burden, and it is disappointing to the Inland Revenue. But the court will not stretch the terms of taxing Acts, in order to improve on the efforts of Parliament and to stop gaps which are left open by statutes. Tax avoidance is an evil, but it would be the beginning of much greater evil, if the courts were to overstretch the language of the statute in order to subject to taxation people of whom they disapproved."[47]

---

45. (1949) 2 K.B. 481 at p. 499.
46. Supra note 6 at p.547. Law Commission of India, 29th Report, 1966 at p.54; British Tax Encyclopedia, G.S.A. Wheatcroft, (1971) Vol.I, para 1-070.
47. (1949) 1 All E.R. 1108, p. 1120; Similar principle has been followed in Pott's Executors v. I.R.C. (1951) 1 A.C. 443; I.R.C. v. Wolfson, (1949) 1 A.E.R. 865,868; Attorney-General v. A.W.Gamgo Ltd. (1949) 2 A.E.R. 732, 734.

Similarly, in Griffiths (Inspector of Taxes) v. J.P. Harrison (Watford) Ltd.[48], the House of Lords approved a dividend stripping transaction, entered into purely for tax avoidance, relying on the principle of strict construction of statutes. Viscount Simond said that:

> "It appears to me to be wholly immaterial, so long as the transaction is not a sham..., what may be the fiscal result or the ulterior fiscal object of the transaction, and since this can be the only ground upon which the commissioners could have reached their determination, I must conclude that it cannot be upheld."[49]

---

48. (1963) A.C. 1 (H.L.). The respondent company, dealers in shares purchased issued shares to the value of £16,900 in Caliborne Ltd., upon which there was a declaration of a net dividend of £15,901, 19s. 3d. Later on, the shares were sold for their nominal value of £1,000. This being the sole share transaction carried out by the company in 1953-54, it claimed a loss, on account of the sale of the shares, under section 341 of the Income Tax Act, 1952. The claim was rejected by the commissioners, on the ground that the respondent company was neither carrying on trading or doing any adventure in the nature of trade in shares during the year in question. But the Court of Appeal and the House of Lords upheld the respondent's claim. (Lord Reid and Lord Denning dissenting). Lord Denning said at p.20 "There was only one true and reasonable conclusion to which the commissioners could come, namely, that the transaction was "an adventure in the nature of trade". "Here was a company", he said, "which was authorised to deal in shares. It bought shares, received a dividend from these shares, and then sold them. What detail does it lack?"

49. Ibid at p.12.

In Bishop (Inspector of Taxes) v. Finsbury Securities Ltd.[50], the House of Lords appears to have taken a somewhat stiff attitude towards tax avoiders, and perhaps acted with an eye to the substance of the transaction to be taxed, rather than its form, and distinguished the previous case of Griffiths v. Harrison[51], though the transaction was of a similar nature.

The facts in brief are that the respondent was incorporated in 1956, as a dealer in shares and securities. Relying on the Revenue practice, and with a view to avoid income tax under section 341, Income Tax Act, 1952, the respondents, in the years 1958 to 1960, entered into fifteen sets of transactions with other companies, described as 'forward stripping'.

The question was whether companies acquired shares in these other companies in the course of their trade, so that they could claim a loss of business.

The House of Lords observed that, as it was the object of the transactions that the future interests of the vendors of the shares should be safeguarded and that the shares should be retained by the taxpayer company during the period of the transactions, the shares were not required for the purpose of dealing in shares and the transactions, although they were real, were wholly artificial devices to

---

50. (1966) 1 W.L.R. 1402.
51. (1963) A.C. 1 (H.L.).

secure tax concessions and therefore not adventures or concerns in the nature of trade, within the statutory definition.

However, in a recent decision of I.R.C. v. Brander and Cruick Shank[52], the Court rejected the Commissioner's claim that the compensation received by the respondent, a firm of advocates, on termination of their appointment as secretary or registrar of two companies, was revenue receipt chargeable under Schedule D, Case II of the Income Tax Act of 1922. Their Lordships distinguished this case from the case of Blackburn v. Close Brothers Ltd.[53], in which it was held that the sum received in respect of the termination of a contract of service of a secretarial nature was a trading receipt, on the ground that the taxpayers in the latter case were a firm of merchant bankers, whose trading activities might include the serving of secretaryships, whereas it was not part of the normal profession of a law agent to act as a registrar or secretary.

The distinction drawn on this ground between these two cases does not appear to be sound, which perhaps their Lordships realized afterwards, when they side tracked the main issue and said that:

---

52. (1971) 1 W.L.R. 212.
53. (1960) 39 T.C. 164; see Ellis v. Lucas (1967) Ch 858; Walker v. Carnaby (1970) 1 W.L.R. 276.

> "In any case, once it is decided that the emoluments of the office of the registrar are taxable under Schedule E, it is not legitimate to attribute the compensation for termination of the office to Schedule D."[54]

In this connection the case of Restorick (Inspector of Taxes) v. Baker[55], recently decided by the Chancery Divisioh is very interesting. The case is a good illustration of the extent to which the judges are still bound by their traditional outlook and are prisoners of precedent.

This was an appeal from a decision of the General Commissioner, holding that the respondent should suffer no deduction in personal reliefs under section 14(4) of the Finance Act,(1968), in respect of allowances received by him for his second child.

The taxpayer, who had two children, aged 11 and 7, received an allowance under the Family Allowance Act, 1965, for his younger child. The taxpayer's total income of £1,991 for the assessment year 1968-69, was reduced to a net chargeable income of £815, as a result of personal and capital allowances admissible to him. The amount of personal relief was, however, reduced by a sum equal to the amount of tax at the standard rate of £36, by virtue of section 14(4) of the Finance Act, 1968.

The relevant portion of sub-section (4) of section 14 provided that:

---

54. (1971) 1 W.L.R. 212, 220.
55. 'The Times', March 5, 1971, p.21 (Columns 1 to 3).

"Where an individual is assessable to income tax... in respect of payments on amount of an allowance or allowances under the Family Allowance Act, 1956... the total deduction from tax to which, apart from this section, the individual...would be entitled under... the Income Tax Act of 1952 (certain personal reliefs) shall be reduced, for each allowance <u>if more than one</u>, by an amount equal to tax at the standard rate on £36 ..."

The question for interpretation was whether a taxpayer, who, having only one allowance, because he had two children, suffered no reduction in his personal reliefs, would suffer a reduction in respect of both his allowances if he had three children.

It was contended on behalf of the Crown that the intention of the sub-section could not be to free a person who received only one allowance from the reduction while a person with two would suffer reduction on both. It was further pleaded that, even if the apparent intention of the sub-section conflicted with the strict wording, the intention of the legislature should prevail.

The Court brushed aside the Commissioner's claim and held that the taxpayer was entitled to relief according to the strict provisions of the law, even though it might appear absurd on the face of it. Foster J., who delivered the judgement of the Court said that;

"It would not be concluded that in a section which, though not a charging section, at least increased the liability to tax, the Court could disregard clear words to accord with the intentions of the legislature. However absurd it might be that a taxpayer with two children was not liable to a reduction in reliefs, while one with three children suffered a reduction in respect of each of his allowances, the Court could not rectify the mistake by disregarding the words used."[56]

Perhaps one cannot visualize the impact of this solitary case on the exchequer. It is estimated that the Inland Revenue stand to lose tens of millions of pounds in a full year in income tax as a result of this decision[57].

It appears from the perusal of cases dealing with tax avoidance, that the law on the point is in a very sorry state. The Courts have not been able to evolve a set principle of interpretation in such cases, in conformity with social and economic needs of the community. Perhaps Lord Denning's approach, to look at the substance rather than the form, would be the best under the circumstances[58].

Judicial Approach in India

The highest judicial authorities in India, as in the United Kingdom, Canada, Australia, Israel and many other countries have followed the traditional rules of statutory interpretation in construing taxing statutes. A court would interpret a taxing statute on the basis of the plain intendment of the word[59], even if such construction leads

---

56. Ibid.
57. Ibid., at p.1.
58. See supra p. 142.
59. C.I.T. Madras v. Ajax Products Ltd., (1965) 56 I.T.R. 741,747 (S.C.)=A.I.R. 1965 S.C. 1358; C.I.T. v. Shahzada Nand & Sons (1966) 60 I.T.R. 392, 400 (S.C.) C.I.T. M.P. and Bhopal v. Sodra Devi, A.I.R. 1957 S.C. 832,835.

to hardship or is against the spirit of the law[60]. Similarly, in cases where the Legislature has failed to use appropriate words in the statutes, the Courts would give the benefit to the taxpayer[61], even though it will result in the taxpayer obtaining a double advantage[62], which was never contemplated by Parliament. The burden is on the Income Tax authorities to show that the income is liable to be taxed under the statute[63]. Of course, the assessee will have to prove an exemption in his favour from taxation, if he wants to take advantage of such provision[64].

---

60. C.I.T. v. Provident Investment Co. Ltd., A.I.R. 1967 S.C. 664 C.I.T.,A.P. v. Motors and General Stores (Private Ltd., (1967) 66 I.T.R. 692, 699-700 S.C.
61. State of Bombay v. A.& A. Industries Corporation (1961) 12 S.T.C. 122,125 (S.C.), C.I.T. Patiala v. Shahzada Nand A.I.R. 1966 S.C. 1342 = (1966) 3 S.C.R. 379. Charitable Gadodia Swadeshi Sotres v. C.I.T. A.I.R. 1944 Lah 465; Upper India Chamber of Commerce v. C.I.T., A.I.R. 1948 All. 64; C.I.T. v. C.S. Sastri A.I.R. 1959 Mad. 250; Ambika Silk Mills Co. Ltd. v. C.I.T., Bombay A.I.R. 1952 Bom. 483.
62. C.P. & Berar Provincial Co-operative Bank Ltd. v. C.I.T. A.I.R. 1946 Nag 216; (1946) I.T.R. 479, 481.
63. The Law and Practice of Income Tax, J.B. Kanga and N.A. Palkhivala, Vol.I; 6th ed. 1969 p.11.
64. Chidambaram Chettier v. C.I.T., Madras, A.I.R. 1966 S.C. 1453, 1457; C.I.T. v. Ramakrishna Deo A.I.R. 1959 S.C. 239; Udhavdas Kewalram v. C.I.T. (1967) 66 I.T.R. 462 S.C.; C.I.T. v. Maharaja Visweswar Singh, (1935) I.T.R. 216 219; Rani Amrit Kunwar v. C.I.T. (1946) I.T.R. 561, 575; Madras Provincial Co-operative Bank Ltd. v. C.I.T.(1933). I.T.R. 158, 165, 165.

In regard to tax avoidance cases, the Judiciary in India, like the English Courts[65] have upheld the right of the citizen and the resident to arrange his affairs so that he pays the minimum amount of tax, by adopting ingenious devices and by making use of the loopholes of the law[66]. In other words, the Indian Courts have acknowledged the act of avoidance as legal. For instance, the Allahabad and Madras High Courts, as long ago as 1922, in re Mukund Sarup[67] and C.I.T. v. T.K.S. Ibrahiman Ravuttar[68], and the Patna High Court in 1930, in Rajniti Prasad Singh v. C.I.T. Bihar and Orissa[69], recognized the act of avoidance as legal and lawful. Asworth J., of the Allahabad High Court said that:

> "It is not unlawful to avoid, by any means not forbidden by law, rendering oneself liable to the payment of income tax, though it is an offence by false return or by concealment to evade payment of income tax."[70]

---

65. See supra pp.132/36 For English Courts attitude to tax avoidance. See (1946) 47 Corpus Juris Secundum, Sec. 994 at p. 1252:
"It is not an offence for the taxpayer to attempt to avoid the payment of an excessive or unjust tax, or so to handle his affairs, provided his acts are legal, as to avoid or reduce tax liability."
Continental Oil Company v. Jones. 111 F (2 d) 587.
66. Jivajeerao Cotton Mills Ltd. v. C.I.T. and E.P.T. A.I.R. 1959 S.C.270; Raghbir Singh Sandhawalia v. C.I.T. A.I.R. 1958 Pun. 250; C.I.T. v. M. & S.M. Railway Co. Ltd., (1943) I.T.R. 380,388; in re Central Talkies, Matunga, Bombay, 1941 I.T.R. 44,51 Punjabhai Dipchand v. C.I.T., A.I.R. 1949 Bom. 415; C.I.T. v. Raman & Co. A.I.R. (1968). S.C. 49.
67. A.I.R. 1928 All. 81 (F.B.).
68. A.I.R. 1928 Mad. 543 (F.B.).
69. A.I.R. 1930 Pat. 33 (F.B.).
70. Supra note 67 at p. 84.

The Allahabad High Court in <u>Ganga Sagar</u> v. <u>Emperor</u>[71], in which the assessee had concealed a substantial part of income, earned from dividends and submitted a false return; went a step further and advised a taxpayer to use all possible devices to reduce tax liability. The Court said:

> "...[A] man who is liable to pay a tax is entitled to take shelter under all devices which he may adopt, within the law, to avoid payment of the tax."[72]

Similarly, the Bombay High Court in <u>re Bai Sakinaboo</u>[73], while refusing to answer the question as to whether there was a partnership or firm, which ought to be registered by the Income Tax Officer, said there was nothing wrong in avoiding taxes and one is at liberty to reduce tax liability. The Court went a step further in <u>re Central Talkies Circuit, Matunga</u>[74] and suggested devices to avoid taxes. Beaumont C.J. said:

> "...[I]f a man finds that he will suffer less in taxation by carrying on business in partnership with his mother rather than his wife, he is entitled to select his mother".[75]

Likewise, the Madras High Court observed, in <u>Devarajalu Chetty and Co., Madras</u> v. <u>C.I.T., Madras</u>:

> "...[I]n income tax cases the same result in a business sense may be reached by means of transactions clothed in two different legal forms, one of which may attract tax or exemption from tax, while the other may not. It has been said on high authority that a person is entitled to so arrange his affairs as not to attract taxes imposed by

71. A.I.R. 1929 All 919.
72. <u>Ibid</u> at p.923 per Mukherjee J.
73. A.I.R. 1932 Bom. 116, per Beaumont C.J. at p.117.
74. A.I.R. 1941 Bom. 205.
75. <u>Ibid</u> at p. 206.

> statute provided he acts within the law, if he succeeds in ordering them so as to secure this result, he cannot be taxed, however unappreciative the revenue authority may be of his ingenuity."[76]

In that case two partners of an old firm of five retired and the remaining partners carried on the business as a new firm. The new firm paid Rs. 6399 to each of the partners at the time of the dissolution of the partnership, as the price of their releasing all interest in the partnership assets, including goodwill and Rs. 18,911 in respect of the forward contracts, for the purchase of goods from abroad, which had been entered into by the old firm, but the deliveries were made after the new firm came into being. It was held that the sum of Rs. 18,911 was deductible under section 10(2)(xv) of the Act of 1922, as revenue expenditure, laid out solely and exclusively for the business of the new firm, while the former sum was not daductible being capital expenditure. Section 10(2)(xv) says:

> "Such profit or gains shall be computed after making the following allowances, namely:-
> ....
> any expenditure....laid out or expended, wholly and exclusively for the purpose of such business, profession or vocation."

It is submitted with respect, that there is no difference in the nature of the two sums; both the amounts were paid as compensation for releasing retiring partners' interest in the old firm, and even if the forward contracts had to be considered separately and in isolation from the

---

76. A.I.R. 1950 Mad. 718 at p. 722 (para 10).

rest of the business, the sum of Rs. 18,911 was the price paid for the acquisition of the interest of the retiring partners in those unexecuted contracts and would still be in the nature of capital expenditure not deductible in the computation of the profits and gains of business.

The Indian Courts have not adopted the 'doctrine of motive' in deciding the legality of a tax avoidance transaction. In other words, the Courts will not turn down a tax avoidance scheme on the ground of the assessee's motive. The Judiciary has invariably upheld schemes for reducing tax liability, even if adopted with the sole motive of tax avoidance.

In C.I.T., Madras v. Ibrahimsa Ravuttar[77], the assessee lent a certain sum of money at a fixed rate of interest. With a view to avoiding income tax on the interest earned, the parties entered into a circuitous transaction. A usufructuary mortgage[78] was executed in favour of the

77. A.I.R. 1928 Mad. 543; Raghbir Singh Sadhawalia v. C.I.T. (1958) 34 I.T.R. 719; A.I.R. 1958 Pun. 250.

78. The Transfer of Property Act, 4 of 1882, sec. 58 cl. (d) defines usufructuary mortgage. The sub-clause says: "Where the mortgagor delivers possession or expressly or by implication binds himself to deliver possession of the mortgaged property to the mortgagee, and authorizes him to retain such possession until payment of the mortgage money, and to receive the rent and the profits accruing from the property, or any part of such rents and profits, and to appropriate the same in lieu of interest, or in payment of the mortgage money, or partly in lieu of interest or partly in payment of the mortgage money, the transaction is called a usufructuary mortgage." Quoted from 'Mulla on the Transfer of Property Act, 1882, Fifth ed. p. 362.

assessee money lender to secure payment of interest, so that the income would be exempt from tax under section 4(3)(viii) of the Act of 1922, being 'agricultural income'. In fact, the parties never intended it to operate and on the same day the properties covered by the usufructuary mortgage were given back to the mortgagor on lease, at a rent equivalent to the amount of interest.

It was held, that the interest was exempt from taxation under section 4(3)(viii) of the Act. The Court stated that:

> "There can be no question... of considering the motives of the assessee in bringing about a particular arrangement because, as has been pointed out by the House of Lords in more than one case, it is not proper to take such motives or object into consideration."[79]

Again, in Meyyappa Chettiar v. C.I.T., Madras, while deciding the question whether partition of a joint Hindu family business had taken place, for the purpose of section 25A of the Act of 1922, which dealt with the assessment, after partition, of a Hindu undivided family, Satyanarayan Rao J., said:

> "So long as a transaction is legal, however reprehensible the object may be, it must be given its effect in law, unless there is a statutory provision invalidating it on the ground that the main purpose is to evade or get a tax reduced."[80]

Similarly, the Bombay High Court in Punjabhai Dipchand v. C.I.T., & E.P.T., Bombay,[81] said that the motive of tax avoidance is no ground for nullifying a business transaction.

---

79. Supra note 77 at p. 544.
80. A.I.R. 1951 Mad. 506 at p. 514 (para 17).
81. A.I.R. 1949 Bom. 415.

The assessee was a firm carrying on business at Ahmedabad in piece goods, and the partners of the firm were Punjabhai, Dipchand and Gokuldas Chhotalal. On June 28, 1941 another firm of the same name was started in Wadhwan State (then a Princely state) with one more partner, in order to take advantage of section 5 of the Excess Profit Tax Act[82], under which the profits of business in the Princely States were exempt from profit tax. The Excess Profit Tax Officer, under section 10 A[83] of the Excess Profit Tax Act, which deals with transactions designed to avoid or reduce liability to excess profit tax, adjusted the liability of the assessees to excess profits tax, by adding to their profits accruing in Ahmedabad, the profits which accrued to them in the Wadhwan State.

---

82. Excess Profit Tax Act, 1940 sec. 5 says that:
"This Act shall apply to every business of which any part of the profits made during the chargeable accounting period is chargeable to income tax...
Provided that this Act shall not apply to any business, the whole of the profits of which accrue or arise without (the taxable territories), where such business is carried on by or on behalf of a person who is resident but not ordinarily resident in (the taxable territories), unless the business is controlled in India.

83. Section 10A says that:
"(1) Where the Excess Profits Tax Officer is of the opinion that the main purpose for which any transaction or transactions was or were affected... was the avoidance or reduction of liability to excess profit tax, he may,... make such adjustments as respects liability to excess profit tax as he considers appropriate, so as to counteract the avoidance or reduction of liability to excess profit tax, which would otherwise be effected by the transaction or transactions."

It was held that the assessee was not liable to pay tax in respect of profits accruing outside British India and so section 10 A was inapplicable. M.C. Chagla, C.J. said that:

> "The motive of the assessee for opening the business is entirely immaterial and irrelevant. It is no concern of the Department how an assessee should conduct and carry on his business, and even if an assessee deliberately chose to start a business in a part of India where no excess profit tax is payable, he was perfectly entitled to do so and he was within the law in doing so."[84]

The Courts in India rejected the prevailing view that tax avoidance, being immoral, should be discouraged and condemned, have taken a purely legislatic view, which does not even hold good today in the materialistic western world[85]. At times the judiciary, the guardian and protector of social and economic interest of the community, has not only approved tax avoidance devices, but has encouraged sagacious taxpayers. The courts have applauded their actions in outwitting the tax authorities and proclaimed in bold and unequivocal language that there is nothing immoral or unethical in reducing one's tax burden by subterfuge, within the circumference of the law[86]. In a recent case of Aruna Group of Estates v. State of Madras, Jagadisam J. affirmed the Court's view on the subject of morality in tax avoidance cases in the following terms:

---

84. Supra note 81 at p. 416 (para 2).
85. See supra pp. 136-42.
86. Meyyappa Chettiar v. C.I.T., Madras A.I.R. 1951 Mad. 506, 519; Punjabhai Dipchand v. Commr of Excess P.T. A.I.R. 1949 Bom. 415,416.

"Avoidance of tax is not tax evasion and it carries no ignominy with it, for, it is sound law and, certainly, not bad morality, for anybody to so arrange his affairs as to reduce the brunt of taxation to a minimum."[87]

Similarly, the Supreme Court held in C.I.T., Gujarat v. A. Raman and Company, that:

"Avoidance of tax liability by so arranging commercial affairs that charge of tax is distributed is not prohibited. A taxpayer may resort to a device to divert the income before it accrues or arises to him. Effectiveness of the device depends not upon considerations of morality, but on the operation of the Income Tax Act. Legislative injunction in taxing statutes may not, except on peril of penalty, be violated but it may lawfully be circumvented."[88]

The application of the economic approach in interpreting taxing statutes is unknown to the Indian courts. The judiciary will not invoke'economic considerations' to strike down a tax avoidance transaction or to distinguish 'substance' from 'form' or 'sham' from 'reality'. Though, in recent years, courts have casually used the phrase 'economic reality' in some cases, possibly from considerations of social responsibility, which had, in fact, no bearing on the decision of the case. For instance, V. Ramaswami, C.J., while delivering the judgement of the Patna High Court in Maharajadhiraj Sir Kameshwar Singh v. C.I.T,, remarked that;

"In my opinion it is not possible, in the circumstances of this case, to ignore or disregard the mask of corporate entity or to analyse the economic realities behind the transactions of sale."89

87. (1965) 55 I.T.R. 642 at p.648.
88. A.I.R. 1968 S.C. 49,53 (para 9).
89. A.I.R. 1964 Pat. 231 at p. 235 (para 5).

In fact, the economic factor was not a decisive factor in the case. The assessee floated a private limited company with an authorized capital, made up of 25,000 shares of Rs. 100 each. The company took over the publication business of the assessee as a going concern, along with its assets and liabilities. In consideration of the transfer, the company allotted to the assessee 12,500 shares and another 12,500, for cash paid by the assessee to the company. Since, according to the sale deed the value of the movable and immovable properties transferred by the assessee to the company was in excess of the written down value[90], the Income Tax Officer taxed the assessee on the difference between the sale price and the written down value under the second proviso to section 10(2)(vii), of the Act of 1922 (corresponding to sections 32(i)(iii) and 41 (2) of the Act of 1961). The relevant portion runs like this:

> "(2) Such profits or gains shall be computed after making the following allowances, namely:-
> ....
> (vii) in respect of any such building, machinery or plant which has been sold or discarded or demolished or destroyed, the amount by which the written down

---

90. Income Tax Act, 1961, sec. 43 (6) corresponding to section 10 (5) of the Act of 1922, says: "written down value means-
(a) in the case of assets acquired in the previous year, the actual cost to the assessee;
(b) in the case of assets acquired before the previous year, the actual cost to the assessee less all depreciation actually allowed to him under this Act, or under the Indian Income Tax Act, 1922...".

> value thereof exceeds the amount for which the building, machinery or plant, as the case may be, is actually sold or its scrap value:
>
> ....
>
> Provided further that where the amount for which any such building, machinery or plant is sold, whether during the continuance of the business or after the cessation thereof, exceeds the written down value, so much of the excess as does not exceed the difference between the original cost and the written down value shall be deemed to be profits of the previous year in which the sale took place."

The assessee's claim that he was not liable to pay tax on the excess over the written down value of the assets sold to the company, in which he had practically all the shares, because there was no material difference between the vendor and the vendee, and so there was not, in reality, a sale, was rejected by the Court. It was held, that the appellant was liable to pay tax, not on the ground of the economic effect of the decision, but on the ground that the company was a 'legal entity', distinct from its members, and so capable of enjoying rights and of being subjected to duties; any individual might have a business dealing with a company in the same way as with any other individual.

In a fairly recent case, C.I.T., Madras v. Meenakshi Mills, Madurai, Rajendra Mills, Salem and Saroja Mills, Singanallur[91], their Lordships of the Supreme Court acknowledged the relevance of 'economic realities' to exceptional cases. The respondents, the assessees, public

---

91. A.I.R. 1967 S.C. 819.

limited companies engaged in the manufacture and sale of yarn in India, had a branch at Padukottai (a former Princely State). The sale proceeds of the branches were periodically deposited in the branch of the Madurai Bank at Padukottai. The bank was incorporated in 1943, with T. Chettiar as founder Director, the head office being at Madurai. Out of the 15,000 shares of the bank, 14,766 were owned by T. Chettiar, the Director of the bank, who was also the Director of the companies in question, his two sons and the three companies. The companies borrowed money from the Madurai branch of the Bank on the security of its fixed deposits made by their branches at the Padukttai branch of the bank. It was held, that the borrowing in British India, on the security of the fixed deposits made at Padukottai, amounted to a constructive remittance of the property by the branches of the assessee's companies in their hands and that the entire transaction formed part of a basic arrangement or scheme between the creditor and the debtor, that the money should be brought into British India after it was taken outside the taxable territory. As such the transaction was covered by sec 42 (1) of the Act of 1922, which provided that:

> "All income, profits or gains accruing or arising whether directly or indirectly,... through or from any money lent at interest and brought into the taxable territories in cash or in kind ... shall be deemed to be income accruing or arising within the taxable territories,..."

With regard to the respondent's argument, that even if T. Chettiar, a director of the assessee company, knew in his capacity as director of the Madurai Bank that money placed om fixed deposit by the assessee-companies would be transferred to the taxable territory, that knowledge cannot be imputed to the assessee-companies, and so it cannot be said that the transfer was an integral part of the loan transaction attracting section 42 (1) of the Act of 1922, their Lordships of the Supreme Court said that:

> "It is well established that, in a matter of this description, the Income Tax authorities are entitled to pierce the veil of corporate entity and to look at the reality of the transaction. It is true that, from the juristic point of view, the company is a legal personality, entirely distinct from its members and the company is capable of enjoying rights and being subjected to duties, which are not the same as those enjoyed or borne by its members. But in certain exceptional cases, the Court is entitled to lift the veil of corporate entity and to pay regard to the economic realities behind the legal facade. For example, the Court has power to disregard the corporate entity if it is used for tax evasion or to circumvent tax obligation."[92]

The Doctrine of Form and Substance

It is apparent, from the analysis of the cases on the point, that the courts have taken in general a narrow, strict and legalistic view in deciding cases relating to tax avoidance. The Courts hardly bother to look at the substance

92. Ibid. p. 822 (para 7).

or the real nature of the transaction in question, or the motive which led the assessee to adopt a particular course of action. They simply apply the outdated doctrine of 'form' and decide the cases on the legal basis of the transaction, irrespective of its social, moral and economic consequences. And where the Courts have invoked the doctrine of substance, they have done so to assist taxpayers to avoid payment of taxes, rather than to check tax avoidance[93].

The application of the doctrine of 'form' in tax cases has continued since the early stage of tax legislations[94], and the judiciary has given its whole-hearted support to the assessee from time to time. Recently, this conservative doctrine received the blessing of the highest judicial authority of the land. Their Lordships of the Supreme Court held in C.I.T., Andhra Pradesh v. Messrs Motors & General Stores, that:

---

93. C.I.T., Bombay v. Kolhia Hirdagarh Co. Ltd., A.I.R. 1950 Bom. 51; Sir Kikabhai Premchand v. C.I.T., Central Bombay A.I.R. 1953 S.C. 509; Messrs Assam Bengal Cement Co. Ltd. v. C.I.T., West Bengal, A.I.R. 1955 S.C. 89; The C.I.T., Bombay, E.P.T. Bombay City v. Sir Homi Mehta, I.L.R. (1956) Bom 154; Messrs Rogers & Co. Bombay v. C.I.T., Bombay City II A.I.R. 1959 Bom. 150.
94. Re Mukund Sarup A.I.R. 1928 All. 81; C.I.T. v. T.K.S. Ibrahiman Ravuttar, A.I.R. 1928 Mad. 543; Ranjiti Pransad Singh v. C.I.T., Bihar and Orisa A.I.R. 1930 Pat. 53; Ganga Sagar v. Emperor, A.I.R. 1929 All. 919, 923; Re Bai Sakinaboo A.I.R. 1932 Bom. 116, re Central Talkies Circuit, Matunga. A.I.R. 1941 Bom. 205; Punjabhai Dipchand v. Commr. of E.P.T., Bombay, A.I.R. 1949 Bom. 415; Meyyappa Chettria v. C.I.T., Madras, A.I.R. 1951 Mad. 506.

> "... [T]he doctrine, that in revenue cases the 'substance of the matter' may be regarded as distinguished from the strict legal position, is erroneous. If a person sought to be taxed comes within the letter of the law, he must be taxed, however great the hardship may appear to the judicial mind to be. On the other hand, if the Crown, seeking to recover the tax, cannot bring the subject within the letter of the law, the subject is free, however, apparently within the spirit of the law the case might otherwise appear to be."[95]

In that case the assessee company, in pursuance of an agreement to sell a cinema for a consideration of Rs. 1,20,000, in the form of a transfer of 5 per cent. tax free cumulative preference shares, held by the vendee, executed a deed called an 'exchange deed' in favour of the vendee. The question was whether the transaction in question was 'a sale' within the meaning of the second proviso to section 10 (2) (vii) of the Act of 1922[96], so that the amount by which the written down value exceeded the amount for which the assets were sold, could be included in the taxable profits of the assessee.

It was held, on a consideration of the terms of the document, that the transactions were, in essence, an 'exchange' and not a'sale', and therefore, the provisions of section 10(2)(vii) did not apply.

It may be noted that, in fact, all the conditions required for sale were present. There was a consideration, offer and acceptance necessary for sale. Nevertheless, the Court adhered to the strict interpretation of 'exchange deed'

---

95. A.I.R. 1968 S.C. 200 at pp.204,205 (para 6).
96. See <u>supra</u> p.158/9 for the section and proviso.

and decided the case accordingly.

In C.I.T., Gujarat v. Messrs B.M. Kharwar[97], the Supreme Court reiterated its earlier view on the point, and said that the legal effect of a transaction could not be displaced by probing into the 'substance of a transaction.'

The respondents, a firm carrying on the business of manufacturing, purchasing and selling cloth, closed the manufacturing side of its business and transferred its machines to a private limited company, in the share capital of which the partners had the same interest as they had in the firm.

The question was, whether, on the facts and in the circumstances of the case, the respondents were liable to pay tax under section 10(2)(vii) proviso (ii)[98] of the Act of 1922, on the amount realized, above the written down value of the assets.

The Court did not decide the issue, in view of the absence of a clear finding of the Tribunal that the transaction was a sale. However, Shah, J., while delivering the judgement of the Court, said that the observation made by Bose, J., in Sir Kikabhai Premchand v. C.I.T., Bombay to the extent that, "in revenue cases, regard must be had to

---

97. A.I.R. 1969 S.C. 812.
98. See supra p.158/9 for the text of the section and proviso.

the substance of the transaction rather than its mere form,[99]" was casual, and could not alter the basic rule of legal interpretation, based on the principle of'form'.

Thus, there appears to be no room left for the judiciary to depart from the strict legalistic stand taken by the Supreme Court in the matter. Nevertheless, it will be of interest to discuss in brief the judicial trend in this regard from 1922, when effective income tax legislation came into force in India, with the passing of the Income Tax Act of 1922.

It may be noted, that, though in general the Courts have applied the strict rule of interpretation and adhered to the doctrine of 'form' an undercurrent of sympathy for the application of a more liberal rule and the application of the principle of 'substance' is discernible from time to time. Sometimes the judiciary has tried to introduce the principle of substance in disguise, deciding a case on the basis of its facts and circumstances, and not its legal form and effect. Sometimes, the Courts openly declared that they were applying the doctrine of substance in interpreting taxing statutes, though to help taxpayers to avoid taxes, rather than to declare them liable.

The three earlier cases, re Mukund Sarup[1], C.I.T., Madras v. Ibrahimsa Ravuttar[2] and Rajniti Prasad Singh v.

---

99. A.I.R. 1953 S.C. 509 at p. 510. See infra pp. 175-77 for details of the case.
1. A.I.R. 1928 All 81 (F.B.).
2. A.I.R. 1928 Mad. 543.

C.I.T., Bihar and Orissa[3], decided by the Allahabad, Madras and Patna High Courts respectively, reveal the divergent attitude of the Judiciary in deciding cases involving similar questions of fact and law.

The facts, which were similar in all the cases, their differences being purely phraseological, may be stated briefly as follows. A usufructuary mortgage[4] bond was executed in favour of the assessee, to secure a stipulated sum of money and interest; on the same day the properties covered by the mortgage bond were leased to the mortgagor by the assessee at a fixed rent, equivalent to the amount of interest.

The question for determination was whether the transaction was an unsufructuary mortgage so that the interest stipulated in the mortgage would be 'agricultural income', within the meaning of section 2(1)(a) of the Act of 1922[5], and so exempt from tax under section 4(3)(viii) of

---

3. A.I.R. 1930 Pat. 33.
4. See supra note 78 for definition of 'usufructuary mortgage'.
5. Sec. 2(1)(a) "agricultural income" means:

   (a) any rent or revenue derived from land which is used for agricultural purposes, and is either assessed to land revenue in the taxable territories or subject to a local rate assessed and collected by the officers of the Government as such.

the Act of 1922, or merely a simple mortgage[6], in which case the mortgagee would be liable to pay income tax on the interest earned. Allahabad and Madras High Courts upheld the assessee's claim to a reduction of tax relying on the 'form' of the transaction, whereas Patna rejected the claim on the principle of the 'substance'.

It was obvious from the facts, that the transaction did not amount to an usufructuary mortgage, but was a simple mortgage. The mortgagee did not enter into possession of the mortgaged property, nor did he enjoy the usufruct of the property; nor did he receive rents from the property, which would be a natural consequence of a usufructuary mortgage. The mortagee received nothing but the fixed rate of interest on the loan and it was apparent that the mortagage and the lease were part of one and the same transaction, which was nothing but a simple mortgage. In the words of Courtney-Terrell, C.J.:

---

6. The Transfer of Property Act, (4 of 1882), section 58, clause (b) defines 'simple mortgage' as follows: "Where, without delivering possession of the mortgaged property, the mortgagor binds himself personally to pay the mortgage-money, and agrees, expressly or impliedly, that, in the event of his failing to pay according to his contract, the mortgagee shall have a right to cause the mortgaged property to be sold, and the proceeds of the sale to be applied, so far as may be necessary, in payment of the mortgage-money, the transaction is called a simple mortgage, and the mortgagee a simple mortgagee."

> "...[T]he real and obvious reason for splitting it up into two documents is to enable the *mahajan* (money-lender), who is the assessee, to put forward a specious claim to escape income tax."[7]

Das, J., made this illuminating remark:

> "I am of opinion that we have to look to the substance and not to the form of the transaction...when the two deeds are read together as forming parts of one transaction, there is little doubt that the lease is in the nature of machinery for the purpose of realizing the interest. What the mortgagee has in view is the realization of interest and the appropriation of the rents, issues and profits from the lands mortgaged".[8]

In *C.I.T., Madras* v. *The Madras and Southern Maharatta Railway Co. Ltd., Madras*[9], the Madras High Court applied the doctrine of substance without expressing its dissent from the literal rule of 'form'.

The assets of the Madras and Southern Maharatta Railway Company belonged to the Secretary of State and the Company managed the undertaking under the supervision and control of the Secretary of the State for India and the company contributed to the capital and the Secretary of State guaranteed interest on the company's capital, amounting to Rs. 23,33,333, at the rate of 3.5 per cent, Under the original agreement between the parties, out of the gross revenue receipts, the working expenses ans interest on debentures were first to be deducted and the balance was thereafter to be divided between the Secretary of State and the Company.

---

7. *Supra* note 3 at p.35.
8. *Supra* note 3 at p. 40
9. (1943) 11, I.T.R. 380.

This amount of 'guaranteed interest' received by the company was held to be the profit of the company earned in India and taxable in a case between the same parties decided earlier.[10] To avoid the effect of that decision the contract was modified, so that the surplus, after providing for the payment of certain charges and the guaranteed interest payable to the company was to be divided between the Company and the Secretary of State.

It was held that the alteration of the contract did not affect the nature of the guaranteed interest and the amount so paid towards it was assessable as the income of the company.

The Bombay High Court in C.I.T., Bombay v. Evans Medical Supplies[11], relying on the substance rule held that there existed a 'business connection' within the meaning of section 42 (1) of the Act of 1922, in regard to the goods sold outside the taxable territories by the assessee company, registered in the United Kingdom, to the Indian company, their sole authorized agents in India. The relevant portion of the section says that:

> "All income, profits or gains accruing or arising, whether directly or indirectly, through or from any business connection in the taxable territories,... shall be deemed to be income accruing or arising within the taxable territories, and where the person entitled to the income, profits or gains is not

---

10. C.I.T., Madras v. M. and S.M. Railway Co. Ltd. (1940) 8 I.T.R. 280.
11. A.I.R. 1959 Bom. 448.

> resident in the taxable territories, shall be chargeable to income tax either in his name or in the name of his agent, and in the latter case such agent shall be deemed to be the assessee in respect of such income tax."

Their Lordshipa of the High Court took a realistic view and said that:

> "It is well-settled law that the expression 'business connection' is different from, though undoubtedly related to the expression 'business' as defined in the Act. What is insisted by the language of the section is that there should be (i) a business in India (ii) a connection between the assessee and that business; and (iii) the assessee must have directly or indirectly earned income by virtue of or through that connection. It is not necessary that the profit or gains should directly flow from the business connection. It is to be deemed to be the income of the assessee, who may well be a non-resident, even if it has arisen indirectly through the business connection in the taxable territories."[12]

Similarly, the Supreme Court of India in Messrs. Assam Bengal Cement Co. Ltd. v. C.I.T.[13], where section 10 (2)(xv) of the Act of 1922[14] was the subject matter of interpretation, held that the question whether an expenditure incurred in a particular case is 'capital expenditure' or 'revenue expenditure' is a question of fact and not of law.

---

12. *Ibid* at p. 450(para 5).
13. A.I.R. 1955 S.C. 89; Madhowji Dharamshi Manufacturing Co.v. C.I.T. Bombay A.I.R. 1970 S.C. 1811; M.R. Goyal v. C.I.T. Bombay A.I.R. 1969 S.C. 859; Erode Transport (Pvt.) Ltd. v. C.I.T. Madras A.I.R. 1970 Mad. 23 Durga Das Khanna v. C.I.T., Calcutta A.I.R. 1969 S.C. 775;C.I.T. U.P.. v. M/S Madan Gopal Radneylal A.I.R. 1969 S.C. 840.
14. See *supra* p.152 for text of section 10(2)(xv).

In that case the assessee company acquired from the Government a lease of certain limestone quarries. In addition to the rents and royalties, further sums were payable under the special covenants contained in clauses 4 and 5 of the lease as 'protection fees'. It was held, considering the facts and circumstances of the case, that the sum paid as 'protection fees', is in the nature of the 'capital expenditure', not deductible from the total income under the provisions of section 10(2)(xv)[15] of the Act for the purposes of taxation.

It may be noted, on a careful perusal of cases relating to fiscal statutes, that the Courts in India have in general dealt leniently with the commercial class, a well-to-do section of the community as compared with the bulk of the taxpayers. This becomes evident from the fact that the judiciary has invariably applied the 'doctrine of substance' to help ingeneous taxpayers to reduce their tax liablility to the State, either in the name of 'commercial necessity' or 'business transaction'. At times the Judiciary has joined hands with sagacious taxpayers by helping them to avoid payment of their legitimate share of taxes.

The Lahore High Court in re Benarasides Jagannath[16] allowed the assessee to deduct, from the taxable receipts,

---

15. See *supra* p. 152.
16. (1947) I.T.R. 185 (F.B.).

payments made to the owners of land, for extracting earth for the manufacturer of bricks, under section 10(2)(xv) of the Act of 1922. The Court upheld the assessee's plea that the practice adopted in the particular manufacturing concern made it evident that the expenses so incurred amounted to 'revenue expenditure' and not 'capital expenditure', whereas the payments made by the assessee to the owners of the land was to procure raw material for the manufacture of bricks and so amounted to 'capital expenditure', not deductible under section 10(2)(xv) of the Act, as pointed out by the Income tax authorities and the Tribunal.

The Bombay High Court in C.I.T., Bombay City v. Kolhia Hirdagarh Co. Ltd.[17], interpreted section 10(2)(xv) of the Act in favour of the assessee who relied on the business aspect of the transaction.

One G. sold his coal mine and its assets to the assessee company in consideration of a sum of Rs. 75,000 in cash and 500 fully paid preference shares of Rs. 50 each, of the face value of Rs. 25,000 with a minimum annual dividend of four annas (one-fourth of a rupee) for every ton of coal raised. Subsequently, the contract was modified. The preference shares were converted into ordinary shares and the assessee agreed to pay, in lieu of the annual dividend, commission to G at the rate of four annas per ton of steam and rubic coal and three annas per ton of slack

17. A.I.R. 1951 Bom. 51; see C.I.T. Bihar v. Ramniklal A.I.R. 1969 S.C. 862,

coal raised from the colliery.

The question arose as to whether the sum so paid was a capital sum or a revenue sum, deductible from total income under section 10(2)(xv) of the Act of 1922.

It was held that the amount was deductible under the impugned section, though it is evident from the facts that the sum payable as commission was nothing but the payment of a capital sum in instalments for the purchase of the colliery. Perhaps, it would be relevant to quote verbatim a statement made by Chagla, C.J., to show how far the Judiciary has gone in lending its blind support to businessmen in avoidance of taxes. He says:

> "Now, in taxation matters, it is not necessary to construe documents from their purely legal aspect. It is open to us, not merely to look at the documents themselves, but also to consider the surrounding circumstances, so as to arrive at a conclusion as to what was the real nature of the transaction from the point of view of the businessmen, who were carrying out this transaction. In all taxation matters more emphasis must be placed upon the business aspect of the transaction rather than on the purely legal and technical aspect."[18]

In C.I.T. / E.P.T., Bombay v. Sir Homi Mehta[19], the question arose whether the assessee made any profit or gain

---

18. Ibid at p. 53 (underline mine to emphasize); In C.I.T. Madras, v. Mohammad Ibrahim Saheb (1962) 45, I.T.R. 166, the Court ignored the provisions of section 44D (3)(a) of the Act of 1922, which imposes the burden of proof on taxpayers who claim the benefit of section 44 D (1) of the Act.

19. I.L.R. (1956) Bombay 154.

by a transfer, the effect of which was to transfer shares of 20 joint stock companies, held jointly by the assessee and his sons, to a limited company called Homi Mehta and Sons Ltd.

The contention of the Income Tax Department was that Mr. Mehta sold shares in his individual capacity to the company for Rs. 40,97,000, though they had cost him only Rs. 30,45,017, so he made a profit of roughly Rs. 10 to Rs. 11 lacs, which was liable to be taxed. While rejecting the Revenue's claim, their Lordships said:

> "... [A] transaction for the purposes of income tax must be looked at from a commercial point of view. In dealing with commercial men in income tax matters, we must try and understand what is the real commercial result of a particular action taken by a commercial man. Equally so, in trying to determine whether a certain transaction resulted in profits.
>
> We must come to the conclusion that the transaction resulted in real profits, which from the commercial point of view, meant a gain to the person who entered into the transaction, not profits from any narrow, technical or legalistic point of view."[20]

It is submitted with respect, that the Court itself admitted the fact that:

> "... [T]here can be no doubt that, in law, Sir Homi Mehta and his sons were very different entities from Sir Homi Mehta & Sons Ltd."[21]

Nevertheless, while deciding the case the Court ignored the fundamental principle that a company is a distinct personality from its members and as such an individual can transact business with a company[22].

---

20. Ibid at p. 156.
21. Ibid at p. 157.
22. Salmon v. Salmon and Co. (1897) A.C. 22.

Similarly, in Messrs Rogers and Company v. C.I.T. , Bombay[23], where the partners of a firm converted the firm into a private limited company, they themselves becoming the shareholders of the company, having shares in the same proportion as the shares held by them in the partnership, it was held that the transfer of the assets of the partnership to the company by them did not amount to a 'sale', which would operate so as to attract the second proviso to section (10)(2)(vii)[24] of the Act of 1922, to make them liable for tax over and above that payable on the written down value of the assets. It was further held that the transaction did not amount to a sale in the real sense of the term, as the firm and the company were being managed by the same persons.

However, decisions in C.I.T. / E.P.T., Bombay v. Homi Mehta by the Executor's of the estate[25], Messrs. Rogers and Co. v. C.I.T., Bombay[26], C.I.T. Calcutta v. Mugneeram Bangur and Co.[27] are no more valid, in view of the Supreme Court's decision in C.I.T., Gujarat v. Messrs. B.H. Kharwar[28].

Nevertheless, the Supreme Court's decision in Sir Kikabhai Premchand v. C.I.T., Bombay[29], in which the doctrine

---

23. A.I.R. 1959 Bom. 150.
24. See supra pp.158/9 for text of S.10(2)(vii) and proviso.
25. A.I.R.1956 Bom. 415.
26. A.I.R. 1956, Bom. 150.
27. (1963) 47 I.T.R. 565 (cal.)
28. A.I.R. 1969 S.C. 812.
29. A.I.R. 1953 S.C. 509.

of substance was invoked in favour of the assessee, still holds good, as the Court in Messrs. B.M. Kharwar, while reviewing judgement in the case, simply said that the reference of the doctrine of substance was casual and nothing more[30].

Sir Kikabhai, who was a dealer in silver and shares, withdrew some silver bars and shares from the business and settled them upon trust, in favour of himself, his wife and children, of which he was the Managing Trustee. The deeds of the trust were valued, for the purposes of stamp duty, at the current market value of the shares and silver. Accordingly the Income tax authorities sought to tax the difference between the cost price of the assets withdrawn and their market value at the date of their withdrawal from the business.

The Court while holding that no income arose to the assessee as a result of the transfer of shares and silver bars to the trustee, said that:

> "It is well recognized that in revenue cases regard must be had to the substance of the transaction rather than to its mere form. In the present case, disregarding technicalities, it is impossible to get away from the fact that the business is owned and run by the assessee himself. In such circumstances, we are of the opinion that it is wholly unreal and artificial to separate the business from its owner and treat them as if they were separate entities trading with each other and then

---

30. See supra pp.164/5 for the facts of Messrs. B.H. Kharwer's case.

> by means of a fictional sale introduce a fictional profit which in truth and in fact is non-existent."[31]

In the case of J.K. Woollen Manufacturers v. C.I.T., U.P., where the question was whether an account claimed as expenditure was laid out or expended wholly or exclusively for the purpose of business, profession or vocation as required under section 10(2)(xv) of the Act of 1922, their Lordships held that:

> "... [I]n applying the test of commercial expediency for determining whether an expenditure was wholly and exclusively laid out for the purpose of the business, reasonableness of the expenditure has to be adjudged from the point of view of the Income Tax Department."[32]

However, in Messrs. Bengal Enamel Works Ltd. v. C.I.T., West Bengal[33], the Supreme Court moved slightly from its rigid stand on the point. In this case it was held that where the amount paid to an employee, pursuant to an agreement, was excessive, because of extra commercial consideration', the taxing authorities could disallow a part of the amount or expenditure not incurred wholly or exclusively for the purpose of the business.

Nevertheless, the basic proposition remains the same. This has been unequivocably affirmed by the Supreme Court, in the recent case of C.I.T., Bihar & Orisa v. Messrs Kirkanand Coal Company[34], that admissability of an allowance

---

31. A.I.R. 1953 S.C. 509 at p. 510 (para 10).
32. A.I.R. 1969 S.C. 609 at p. 612 (para 5).
33. A.I.R. 1970 S.C. 1076.
34. A.I.R. 1970 S.C. 1586. See Bombay Steam Navigation Co. C.I.T., Bombay A.I.R. 1965 S.C. 1201.

or expenditure has to be judged, not from the point of view of the revenue but from the standpoint of the businessman.

This appears to be hardly satisfactory. There should be a balance between the interest of the revenue and that of the taxpayer.

The Doctrine of Literal Interpretation

One is amazed to note the extent to which the Courts have gone in interpreting provisions relating to statutes, enacted to check tax avoidance. At times the Courts have taken a very rigid and narrow view and imposed a restricted meaning, which was not contemplated by the legislature, and which does not even conform to the ordinary meaning of the term.

In C.I.T., M.P. and Bhopal v. Mrs. Sodra Devi and Mrs. Danayanti Sahni v. C.I.T.[35], the questions for determination were whether the word 'individual' in section 16 (3)(a)(ii) of the Act of 1922 (corresponding to section 64 of the Act of 1961) includes a 'female', and whether the income of the minor sons, derived from a partnership, to the benefits of which they had been admitted, was liable to be included in the income of the mother, who was a member of that partnership. Section 16 (3) says that:

---

35. A.I.R. 1957 S.C. 832. See C.I.T., Madras v. M.K. Stremann A.I.R. 1965 S.C. 1494.

(3)" In computing the total income of any individual for the purpose of assessment, there shall be included-

(a) so much of the income of a wife or minor child of such individual as arises directlt or indirectly-

(i) from the membership of the wife in a firm of which her husband is a partner;

(ii) from the admission of the minor to the benefits of partnership in a firm of which such individual is a partner;

(iii) from assets transferred directly or indirectly to the wife by the hudband otherwise than for adequate consideration or in connection with an agreement to live apart; or

(iv) from assets transferred directly or indirectly to the minor child, not being a married daughter, by such individual otherwise than for adequate consideration; and

(b) so much of the income of any person or association of persons as arises from assets transferred otherwise than for adequate consideration to the person or association by such individual for the benefit of his wife or a minor child or both."

The Court took a very narrow view of the term 'individual' used in section 16(3)(a)(ii) of the Act and said that the term has been used in a restricted sense to include male only, i.e.'individual capable of having a wife or minor child or both'[36], on the plea that the section 16(3) was enacted with a view to check tax avoidance, resulting from the widespread practice of a husband entering into a nominal partnership with his wife and minor children; so, by implication, it excluded 'females' and the mother's claim that the income of her minor sons, derived from a partnership, to the benefits of which they had been admitted,

36. Ibid. at p.835, para 11.

was not liable to be included in the income of the mother, who was a member of that partnership within section 16 (3) (a)(ii) of the Act.

It is submitted, with respect, as said by S.K. Das J., in his dissenting judgement, that there is nothing in the context of section 16 which confines the word 'individual' to a male individual only. Had the legislature intended to confine the entire section to a male individual only, nothing could have been easier than to qualify the word 'individual' by the adjective 'male' in the first part of the sub-section, which controls both clauses (a) and (b); alternatively, in clauses (iii) and (iv) 'father' could have been used in respect of 'such individual'[37]

However, the decision does not apply to the corresponding section 64 of the Act of 1961, in which the word 'individual' obviously includes 'females' as well[38].

Similarly in <u>Philip John Plasket Thomas</u> v. <u>C.I.T.</u>, <u>Calcutta</u>,[39] where section 16 (3)(a)(iii) of the Act of 1922, was in issue, the Supreme Court construed the provisions strictly.

---

37. <u>Ibid</u> pp. 842, 843, paras 37, 39. Similar view has been expressed by the Allahabad High Court in <u>Chandra Devi</u> v. <u>C.I.T., Lucknow</u>. A.I.R.,1951, All. 586.
38. <u>The Law and Practice of Income Tax</u>, J.B. Kanga and N.A. Palkhivala (Vol. 1.6th ed. 1969), p. 530.
39. A.I.R. 1964 S.C. 587.

The question for determination was whether the dividends paid to Mrs. Thomas on the shares transferred to her by Mr. Thomas before marriage, could be included in the income of Mr. Thomas, after the marriage, and be taxed in his hands under section 16(3)(a)(iii) of the Act.

It was held that the section did not apply, as the property in question was transferred before the marriage took place. To invoke the section, the relationship of husband and wife should subsist, not only at the time of the accrual of the income but also when the transfer of assets is made.

The Court's view as regards the interpretation of such provisions may be appreciated by the following statement:

> "It [section 16(3)] clearly aims at foiling an individual's attempt to avoid or reduce the incidence of tax by transferring his assets to his wife or minor child, or admitting his wife as a partner or admitting his minor child to the benefits of partnership, in a firm in which such individual is a partner. It creates an artificial income and must be strictly construed."[40]

The Court's own statement made in the case might justify a conclusion contrary to that taken by it. S.K. Das, J., while delivering the judgement of the Court said:

> "On a plain reading of sub-sec. (3) of S. 16 it seems clear to us that, at the time when the income accrues, it must be the income of the wife of that individual, whose total income is to be computed for the purpose of assessment; this seems to follow clearly from cl.(a) of sub-sec. (3). Therefore, in a sense, it is right to say that the relationship of husband and wife must

---

40. Ibid. at p. 590,(para 7). The rule of strict interpretation has recently been approved by the Supreme Court in C.I.T., W.B. v. Prem Bhai Parekh A.I.R. 1970 S.C. 1518, 1519; see C.I.T., Gujarat v. Keshavlal Lallubhai Patel A.I.R. 1965 S.C. 806

> subsist at the time of the accrual of the income; other wise the income will not be the income of the wife."[41]

In C.I.T., Bombay v. Provident Investment Co. Ltd.,[42] the old section 12 B of the Act of 1922,[43] was in issue, which runs as follows:

> "12B. - The tax shall be payable by an assessee under the head "Capital gains" in respect of any profits or gains arising from the sale, exchange or transfer of a capital asset... and such profits and gains shall be deemed to be income of the previous year in which the sale, exchange or the transfer took place."

The assessee company was the managing agent of two other companies D. and S., in which it held a substantial majority of the shares. The Dalmia Investment Company offered to purchase from the assessee company the shares which it held in the two other companies, D. and S, along with the managing agency of these companies, at a certain rate per share. The board of directors of the assessee company resolved to accept the offer and further that, out of the total amount received from the sale of the shares, Rs. one crore should be paid to the assessee company as compensation for the loss of the managing agency. However, the assessee company, in pursuance of a request from the

---

41. Ibid. at p.591.
42. A.I.R. 1957 S.C. 664.
43. Section 12B was first introduced by the Excess Profit Tax (Amendment) Act, 1947, in the Income Tax Act, 1922. According to the provisions of the section 'capital gains' arising after the 31st March, 1946, became subject to tax. The tax was abolished by the Finance Act, 1949, but it was reintroduced by the Finance Act, (3 of 1956) with effect from April 1, 1957. Since then it is continuing. The Act of 1961 has made elaborate provision relating to capital gains under sections 45 to 55.

Dalmia Investment Company, resigned from the 'managing agency', instead of transferring it to the company at the time of sale.

The question was whether the amount of Rs. one crore, which included a capital gain, estimated by the Income Tax Officer at Rs. 81,81,900 was taxable under section 12 B of the Act of 1922. It was held that the section refers to 'sale, exchange or transfer' and the act of 'resignation' from the managing agency amounted to 'relinquishment'; it was not a transfer or sale, which would attract the provisions of section 12 B.

It is submitted, with respect, that, the net result of the transaction was that the assessee company got Rs. one crore, in lieu of its managing agency, which was a capital asset. It is immaterial whether one calls the transaction a sale, a transfer or a relinquishment, from the revenue point of view. This becomes evident from the fact that the legislature had to add the word 'relinquishment' in section 12 B in 1956, in order to nullify the effect of the decision in question.

In C.I.T., West Bengal v. National & Grindlays Bank Ltd., Calcutta[44], the Calcutta High Court gave a restricted meaning of the term 'money in kind' in sec. 42 (1)[45] of the

---

44. A.I.R. 1969 Cal. 71.
45. See supra p.160 for the text of section 42 (1).

Act of 1922, so as to include bills of exchange, gold and silver bars, ingots etc., as used in the commercial world and not that understood in the ordinary sense of the term or by economists, that 'money' is a medium of exchange and includes whatever is obtained by money, so goods, plant or machinery, bought with money, are the equivalent of money[46].

The assessee, a non-resident sterling banking company, advanced money to the Calcutta Electric Supply Corporation, which was incorporated in Britain, with its head office in London, and was carrying on the business of supplying electricity in Calcutta, to meet its financial obligations in respect of equipment purchased by it in England and brought into and installed in India.

It was held that the plant, goods and machinery so brought was neither money in kind nor cash, within the meaning of the section, so the assessee was not liable to pay tax on the interest earned over the amount advanced by way of loan.

---

46. Supra note 44. Their Lordships of the Calcutta High Court at p. 75,(para 13) gave the definition of money as understood by the economists in the following words: "In the broadest concept and in some schools of economists money is a medium of exchange and money includes whatever is obtained by money. In other words, goods or plants or machinery bought with money are the equivalent of money and should be regarded as money." See for the concept of money, The Legal Aspects of Money, F.A.A. Mann, LL.D. thesis (1938), University of London, pp.36-42. See supra pp. 36 to 42 for definition of Income.

The Supreme Court in C.I.T., Punjab v. R.D. Agrawal & Company[47], gave a restricted meaning to the words 'business connection', used in section 42 (1) of the Income Tax Act of 1922. The assessee company, a registered firm, carried on business as importers and commission agents for non-resident exporters. For two of the non-resident exporters, an Italian and a Belgian, it canvassed orders in Amritsar, for the supply of worsted yarn and communicated the same to his non-resident principals and received commission on the sales made by them. The assessee acted as the 'sole agents for the sale' of the Italian concern and as the exclusive representative of the Belgian concern for the whole of India, on condition that it did not represent any other Belgian Mill or yarn producer and did not sell Belgian yarn in India on his own account.

It was held that there was no 'business connection' between the non-resident exporters and the assessee, because the assessee had no authority to accept orders or enter into contracts on hehalf of the non-residents, within the meaning of section 42(1) of the Act.

It is submitted that the legislature never intended that the words should be given such a narrow meaning. No doubt the final authority vested in the non-residents, but their business was done in India, through the assessee only and it was entitled to get commission on every sale in India.

47. A.I.R. 1965 S.C. 1526.

This fact alone might have been sufficient to establish a 'business connection'. A similar attitude by the Courts was adopted in Hira Mills Ltd., Cawnpore v. I.T.O., Cawnpore[48], Jethabhai Javerbhai v. C.I.T., C.P. and Berar[49], C.I.T., Bombay Presidency & Aden v. Currimbhoy Ebrehim and Sons Ltd.[50], C.I.T., Bombay v. Ahmedbhai Umaabhai & Co., Bombay[51], C.I.T., Gujarat v. Keshavlal Lallubhai Patel[52], C.I.T., Bombay v. Ahmedbhai Advance Mills Ltd.[53]

However, it appears that in some cases the Courts have taken a more realistic attitude and interpreted the provisions in conformity with the context in which they appear. For instance, in Bank of Chettinad Ltd. v. C.I.T., Madras[54] the Privy Council held that a 'business connection' existed between an Indian bank and a foreign bank within sec. 42 (1) of the Act, when both were controlled by the same persons. The loans advanced by the foreign bank to the Indian bank were made outside India, through the foreign branches of the respective banks and were repayable outside

---

48. (1946) I.T.R. 417 (All).
49. A.I.R. 1951 Nag. 351.
50. A.I.R. 1936 P.C. 1.
51. A.I.R. 1950 S.C. 134.
52. A.I.R. 1965 S.C. 866 .
53. A.I.R. 1940 P.C. 36.
54. A.I.R. 1940 P.C. 183. Similar views were taken in the following cases, viz., Bombay Trust Corporation Ltd. v. C.I.T., Bombay, A.I.R. 1928 Bom. 448; on appeal C.I.T. v. Bombay Trust Corporation A.I.R. 1930 P.C. 54; C.I.T. v. Remington Typewriter Co. (Bombay) Ltd. A.I.R. 1931 P.C. 42.

India. But the moneys were brought into India and used in the branches of the bank here.

The Court said:

> "The words [of section 42 (1)] are wide enough to cover profits or gains which can be said to accrue or arise to the ... [foreign] Bank directly or indirectly or from any business connection which may exist between the... [foreign] bank and the ... bank in British India."[55]

In Mazagaon Dock Ltd. v. C.I.T. and E.P.T.[56], the Supreme Court took the correct view and held that the appellant company was liable to pay tax on the profits, which it would have made out of a business transaction with non-resident companies, but for the arrangement, within section 42(2) of the Act of 1922, (corresponding to section 92 of the Act of 1961). Section 42(2) says:

> "Where a person not resident or not ordinarily resident in the taxable territories carries on business with a person resident in the taxable territories, and it appears to the Income Tax Officer that, owing to the close connection between such persons, the course of business is so arranged that the business done by the resident person with the person not resident or not ordinarily resident, produces to the resident either no profits or less than the ordinary profits which might be expected to arise in that business, the profits derived therefrom or which may reasonably be deemed to have been derived therefrom, shall be chargeable to income tax in the name of the resident person who shall be deemed to be, for all the purposes of this Act, the assessee in respect of such income tax."

The appellant was a private limited company incorporated under the Indian Companies Act, and was carrying on business

55. Ibid at p.185.
56. A.I.R. 1958 S.C. 861.

as marine engineers and ship repairers. Its entire capital was owned by two British companies, the P. and O. Steam Navigation Co. Ltd. and the British India Steam Navigation Co. Ltd., whose business consisted in plying ships for hire. Under an agreement entered into with the two companies, the appellant repaired their ships at cost and charged no profits.

The Court took a broad view of the term 'business' used in the section and came to the conclusion that the artificial transaction between the two companies formed a concerted and planned activity to deprive the Indian Revenue of the tax, which would otherwise be payable by the resident; this was computed at Rs. 6,80,000 for 1943-44, at Rs. 4,67,559 for 1944-45 and at Rs.4,68,463 for 1945-46. It was further held that the subject of the charge under the section was the business of the resident and not the business of the non-resident so the appellant was covered by the impugned section.

Again in <u>Chidambaram Chettiar</u> v. <u>C.I.T., Madras</u>[57], where the application of section 44 D(1) (corresponding to section 93 of the Act of 1961), which nullifies the transactions made to avoid taxation by transfer of income to non-residents, was in issue, the Supreme Court took a pragmatic view.

---

57. A.I.R. 1966 S.C. 1453.

The relevant portion of section 44D (1) states:

> "Where any person has, by means of a transfer of assets, by virtue or in consequence whereof, either alone or in conjunction with associated operations, any income which, if it were the income of such person, would be chargeable to income tax, becomes payable to a person resident but not ordinarily resident in the taxable territories, acquired any rights by virtue or in consequence of which he has, within the meaning of this section, power to enjoy such income, whether forthwith or in the future, that income shall,... be deemed to be income of such first mentioned person..."

In that case the assets of a firm, of the net value of Rs. 12 lakhs, were transferred to a corporation, incorporated outside India. The corporation allotted shares worth the said amount to the firm. It was held that section 44D applied in respect of the income of the company derived from those assets, since, by holding a sufficiently large number of shares, the transferor could be said to have acquired a right, by virtue of which he had 'power to enjoy' the income. As regards the appellant's contention that the expression 'by means of a transfer' means the transfer by an assessee and that, as in the instant case, the transfer was by the firm, which was a juristic entity separate from the assessee, the income of the corporation was not assessible in their hands, the Court rightly said:

> "The language of the sub-section is plain. It does not say "when any person has transferred any assets", but it says "by means of a transfer of assets". The person who transfers assets is not designated but emphasis is laid on the consequences flowing from such a transfer. Whosoever effects the transfer, if by such a transfer the assessee acquires a right to enjoy the income, he is liable to tax.The words

> "means" and "acquired" in the context are only words of a passive nature. The hand that transfers is immaterial: what matters is the result envisaged by the said section, namely, a non-resident is the transferee of the assets but the assessee acquires the power to enjoy the income from these assets."[58]

In C.I.T., Madras v. C.M. Kothari[59], the Supreme Court made a correct approach in turning down a tax avoidance scheme entered into by a father and his son. A, the father-in-law, transferred assets worth Rs.30,000 to his daughter-in-law Mrs. B. as a Deepawali present, (Festival of Lights), and B made a gift of almost equal amount to her mother, Mrs. A, as a birthday present. No such gift had been made in the past. It was held that the transactions were so intimately connected as to form part of one and the same transaction, within the meaning of section 16(3)(a)(iii) of the Act[60], though each of the two transfers might not constitute consideration for the other in the technical sense. Their Lordships rightly said:

> "The present case is an admirable instance of how indirect transfers can be made by substituting the assets of another person who has benefited to the same or nearly the same extent, from assets transferred to him by the husband."[61]

On the other hand the Supreme Court in C.I.T., West Bengal v. Prem Bhai Parekh[62], while interpreting the

---

58. Ibid at pp. 1455-1456 (para 5).
59. A.I.R. 1964 S.C. 331; S.Srinivasan v. C.I.T., Madras (1967) 1 S.C.R. 727; Sevantilal Maneklal Seth v. C.I.T., Bombay A.I.R. 1968 S.C. 697; Pavat Kumar Mittar v. C.I.T., W.B. (1962) II M.L.J. 119.
60. See supra note p.179 for text of section 16(3)(a)(iii).
61. Supra note 59 at p. 333 (para 7.).
62. A.I.R. 1970 S.C. 1518.

provisions of section 16(3)(a)(iv) of the Act of 1922 adopted a strict and legalistic approach as opposed to that in C.M. Kothari's case.

The facts were as follows. The assessee was a partner in a firm, having a 7 annas share therein. On July 1st, 1954 he retired from the firm. Thereafter he gave to each of his four sons, three of them were minors, Rs. 75,000. The firm was reconstituted from July 2, 1954; the major son became a partner of the reconstituted firm and his minor sons were admitted to the benefits of that firm, each of them having a two annas share.

The question arose whether the income arising to the minors, by virtue of their admission to the benefits of partnership, came within the purview of section 16(3)(a)(iv)[63] of the Act of 1922, and could be included in the income of the assessee.

The question was answered in the negative. It was held that the income did not come within the purview of the impugned section and so could not be included in the income of the assessee. One fails to understand the conflicting statements made by the Court in one and the same para of the judgement. On the one hand, the Court has admitted that the amount contributed by each of the minors came from his father's gift to him, but on the other hand it said that the connection between the gift and the income in question was remote. In

63. See supra p.179 for text of section 16(3)(a)(iv).

other words, the Court held that there was neither direct nor indirect connection between the trnasfer of the assets and the income in question to make the provisions of section 16(3)(a)(i) applicable.

In fact, the circumstances of the case justify a contrary conclusion. The facts of the assessee's retirement from the firm, making gifts to his sons, the reconstitution of the firm and the sons' admission to the benefits of the firm show that they are at least indirectly connected if not directly.

It became evident, from the analysis of cases on the point, that the Courts in India, like the Courts in Britain, have not been able to evolve a fixed rule or principle of construction as yet. It is regrettable that the Courts are not clear in their approach to such a vital issue. Conflicting decisions can be cited on points arising from similar facts and situations[64]. Standards applied in favour of the taxpayer differ from those applied to the revenue[65].

The question is whether the country can in these times of economic stringency afford so grave a loss from

---

64. See <u>supra</u> pp. 166 to 172.
65. See <u>supra</u> pp. 172 to 186.

the unfavourable decisions of the Courts[66]. The obvious reply is: No; the Courts must come to the aid of the Legislature, as did the Supreme Court of America.[67]

The Approach in other Jurisdictions.

The role of the Supreme Court of America in this context is commendable. The Court has not only paved the way for the legislature tp proceed with its programme of combating tax avoidance legislation[68], but has also by construing such

66. See supra pp.178 to 186 (F); see 'Judicial Techniques in Combating Tax Avoidance', Ralph S. Rice, 51, Michigan L.R. 1021. It is rightly pointed out that the loss of revenue as a result of one decision is not limited to that very case but is followed by others to the advantage of taxpayers. One decision might encourage a large number of tax avoidance transactions, resulting in huge loss to the exchequer. See supra p.148 for the possible impact of the decision of Resorick v. Baker on the exchequer
67. 'The Problem of Personal Income Tax Avoidance', Harry J. Rudick, (1940), 7, Law and Contemporary Problems, p. 243, at pp. 248 to 265; see for the attitude of the Courts in U.K. supra note 11, at pp. 214 to 220; for Canada supra note 6 pp. 545 to 552; for Australia supra note 19, at p131.
68. See Taft v. Bowers (1929) 278 U.S. 470; Lucas v. Earl (1930) 281 U.S. 111; Burnett v. Wells (1933) 289 U.S. 670. The Supreme Court by a majority of five to four upheld the constitutionality of section 219(h) of the Revenue Act of 1924. The impugned section provided for the inclusion of that part of the income of a trust which was to be applied to the payment of premium upon the policiies on the life of the grantor in his income for the purpose of income tax. The Court rejected the respondent's argument that the statute, in so far as it authorized taxing him on the income of the property that was no longer his (because an irrevocable trust was created) infringed the Fifth Amendment. It was held that the trust could not be used for such purposes as were for the exclusive benefit of the family and in such cases it would be deemed that so much of the income of the trust was retained by the testator for his use.

such provisions liberally[69]. Probably Congress would not have advanced far in its battle against income tax avoidance, if the Supreme Court had not stood by it[70]. The Courts have evolved three rules to combat tax avoidance devices, viz., the business purpose rule, the economic approach rule and the search for legislative intentions[71].

---

69. Gregory v. Helvering (1935) 293 U.S. 465. The Supreme Court refused to give a literal meaning to the 'tax free reorganisation' provisions of the Revenue Act, 1928. They incorporated the requirement of 'business purpose' of the transaction, which was not written into the provisions of the statute. Mrs. Gregory, in a technically perfect scheme, carried out a series of transactions, each of which was free from tax liability on a lieral contruction of the statute. The Court, however, brushed aside the 'elaborate and devious' form of the transaction and upheld the revenue's claim to taxation. The Court rested its conclusion on the ground that the statute meant by ' reorganisation' a transaction in furtherance of the recognized corporation's business and that being lacking, the taxpayer's claim could not be upheld. See Higgins v. Smith (1940) 308 U.S. 473. Helvering v. Cliford (1940) 60 Sup. Ct. 554. Lucas v. Earl (1930) 281 U.S. 111.

70. See supra note 67 at p. 248. 'Tax Avoidance Schemes End in Disaster', D. Howe P. Cochran (1950-51) 5 Miami L.Q. 435, 440 'Section 367 and Tax Avoidance', James B. Sitrick (1970) 25, Tax L.R. 429.

71. 'Judicial Technique in Combating Tax Avoidance', Ralph S. Rice, (1953) 51, Mich. L.R. 1021, at pp. 1041 to 1047.; 'Report of the Royal Commission on Taxation: Canada (1966), Vol. 3. pp. 549 to 552.

In Australia[72] and New Zealand[73] also the Courts have endeavoured to remedy some of the statutory deficiencies by giving a liberal interpretation to the provisions of the Income tax statutes[74]. For instance, the Privy Council in Newton v. Federal Commissioner of Taxation[75], a dividend stripping case, gave some life to section 260 of the Australian Income tax and Social Service Contribution Assessment Act, 1936-60[76], by extending the meaning of the word 'arrangement' used in the section so as to cover all transactions, which had the effect of avoiding taxes, whether conveyances, transfers or anything else.

---

72. 'The Legislation against Tax Avoidance: The Australian Experience, H.A.J. Ford, (1961) B.T.R. p. 247. 'The Meaning of the Term 'Arrangement', Peter G. Whiteman, (1966) British Tax Review, p. 399.
73. Bell v. Federal Commission of Taxation (1953) 87 C.L.R. 548.
74. Owen Thomas Mangin v. I.R.C. (1971) 2 W.L.R. 39,52.
75. (1958) A.C. 450. In that case the three Australian companies, which dealt in motor cars, entered into various transactions, the effect of which was inter alia to increase the capital of the motor company in a way which would attract as little tax as possible to enable the shareholders to receive the amount of profits in the form of special dividends, without paying taxes on them and to make it possible for the company to earn huge profits on its deals. It was held that the case was covered by clause (c) of section 260 of the Act because the purpose and effect of the arrangement was to avoid taxes. See I.R.C. v. Europa Oil Co. Ltd. (1971) 2 W.L.R. 55 (P.C.); Dolors Hay v. McClelland v. Commissioner of Taxation (1971) 1 W.L.R. 191 (P.C.).
76. See supra p.126 for text of section 260 of the Act.

And in a recent case from New Zealand, Owen Thomas v, I.R.C.[77], the Judicial Committee pf the Privy Council foiled the appellant's attempt to avoid tax by creation of a 'trust' of his property by invoking section 108 of the Land and Income Tax Act, 1954.

The appellant, a farmer, with a view to avoiding taxes, created a 'paddock trust', whereby he leased 385 acres of his land in parts for one year at £3 an acre to trustees, who were to cultivate it. The trust income was to be held for his wife and children. The appellant was employed by the trustees to sow, harvest and sell the crop, and received remuneration. The remaining income, after deduction of expenses, was to be distributed amongst the beneficiaries of the trust. As a result of these transactions, a part of the appellant's total income became the income of his wife and children, who could claim allowances and reduced rate of tax on the sum and at the same time the tax paid by the appellant was reduced.

The revenue assessed the entire income of the wife and children with that of the appellant, on the ground that the creation of a trust was absolutely void under section 108 of the Act. The impugned section provides that

> "Every contract, agreement, or arrangement made or entered into,... shall be absolutely void in so far as, directly or indirectly, it has or purports to

---

77. (1971) 2 W.L.R. 39 (P.C.).

> have the purpose or effect of in any way altering the incidence of income tax, or relieving any person from his liability to pay income tax."

The Court traced the history of the impugned section, explaining the reason for its enactment and gave a liberal interpretation to the provision. It was held that, since the appellant's principal or sole purpose in creating the 'paddock trusts' was not to provide a trust fund for the members of the family but to escape liability for tax on part of his income, the trusts were void.

In the light of the foregoing discussion, it is clear that the Courts in India and Britain should change their outlook towards tax avoidance cases. They should co-operate with the revenue in defeating tax avoidance devices. Taxation should no longer be considered as extortion of money by the State; it should be regarded as just contribution of the individual to the State for the performance of its social welfare activities and for the economic prosperity of its people.

Everyone should recognize a duty, moral, social and legal to see that the State is not deprived of revenue it needs by the mischievious activities of a few individuals. And the Courts, being the guardians and protectors of the social and economic interests of the State should compel the taxpayer to do his duty. No doubt there has been some change in the attitude of the Courts[78], but it has not been enough

---

78. See <u>supra</u> pp. 186 - 190.

to check tax avoidance, rampant on a large scale in India. This requires a concerted effort, not only by the legislature but the judiciary as well.[79]

---

79. '<u>The Attitude of the Legislature and the Courts to Tax Avoidance</u>, G.S.A. Wheatcroft, (1955) 18 Mod. L.R. 209, 229-230.

CHAPTER V

Tax Evasion

The Nature and Extent of Tax Evasion

The word 'evade' which is a verb of the noun 'evasion', came into use in the English language for the first time in 1513[1]. It has its origin in the French word '<u>evader</u>' which is an adaptation of the Latin term '<u>evadére</u>' formed of two words, namely 'é' (= out) and 'vadere' (= to go) means to go out or to get away or to escape[2]. Gradually, the term 'evade' acquired a special meaning and started to be used to signify an individual's particular course of action. For instance, since 1710 it has been in constant use to denote the act of avoiding one's liabilities, particularly the pressure of a charge[3] by means of an artifice, a trick or subterfuge.[4]

---

1. The Shorter Oxford English Dictionary on Historical Principals, Vol.I (1933) p. 641.
2. <u>Ibid</u>.
3. <u>Websters' International Dictionary of English Language</u> (1903) p.516.
4. <u>Supra</u> note 1 at p. 641; "<u>Whartons' Law Lexicon</u>, A.S. Oppe, 14th Edition (1958) p. 382; <u>The Dictionary of English Law</u>, Clifford Walsh, Vol.I, (1959), p.740.

In the law of taxation, the term 'evasion' at times, is used to indicate or to signify two different types of activity[5], though the effect of both on the economy of the State is one and the same, i.e., both result in loss of revenue to the exchequer[6]. In the first place the term 'evasion' designates those types of activities of taxpayers which though, technically within the four corners of the law, are against the very intent and the policy of the law. In the second place it covers all those fraudulent activities of a taxpayer, which are entered into with a view to escaping payment of taxes to the revenue by adopting illegal means. The former usually applied to tax avoidance[7] and the latter to tax evasion[8]. It is the latter sense of the term that is the subject matter of discussion in the present chapter.

Tax evasion includes in brief all those activities employed by a taxpayer to defraud the revenue by not paying the tax that the existing law imposes upon his income[9].

---

5. Simms v. Registrar of Probates (1900) A.C. 323 (P.C.) Lord Hobhouse said at p.334 that the word 'evade' refers to the two contrasting meanings, viz., "one which suggests under-hand dealing and another which means nothing more than the intentional avoidance of something disagreeable"; Taylor v. Attorney General (1963) N.Z. L.R. 261 at p.262.
6. Report of the Working Group-Central Direct Taxes Administration. Administrative Reforms Commission, Government of India (1968), para 6.1 p. 105.
7. See Chapter 3 for detailed discussion on tax avoidance.
8. See Chapter I pp. 4,5. for the distinction between tax avoidance and tax evasion.
9. Royal Commission on the Taxation of Profits and Income Final Report.Cmd. 9474, H.M.S.O., London (1955), para 1016, p.304.

It covers a wide range of the taxpayer's activities, from making a fraudulent return, deliberately supressing or falsifying the facts relating to one's true tax liability[10] to failure to make a return or to pay taxes in time. Thus tax evasion is always illegal. There is no divergence of opinion as to its nature, as in the case of tax avoidance in the legislature, the judiciary and the revenue. The amount concealed is not material, for the offence of tax evasion is complete, if there is a concealment of income. However, the amount of tax evaded may be taken into account for the purposes of awarding a penalty.

A taxpayer bent upon evasion of taxes by fraudulent means may resort to a number of devices, depending upon the impact of taxation and the prevalent economic and political conditions in the country.[11] It may range from the simple and crude to complex and ingenious methods[12]. A significant feature of tax evasion, like tax avoidance, is that new devices and techniques are evolved from time to time, in order to frustrate the legislature's and Revenue's efforts to minimize and stop evasion. Some of the common forms of the tax evasion devices that are in practice may be enumerated as follows:

---

10. Report of the Direct Taxes Administration Enquiry Committee - 1958-59 Government of India, para. 7.3 at p. 147
11. Incidence of Tax and Tax Evasion, K.C. Khanna, 2nd All India Conference of Tax Executives, 1967; F.I.C. C.I.
12. Penalties and Prosecutions for Evasion of the Federal Income Tax, Gerald L. Wallace (1946). Tax Law Review, (New York University School of Law, 329 at p.336.

(i) omitting to report taxable income,

(ii) making fraudulent changes, manipulations of and altering account books,

(iii) maintenance of a multiple set of account books,

(iv) opening accounts under assumed names,

(v) securing contracts in the name of dummies or figureheads,

(vi) keeping transactions out of account books[13],

(vii) omitting to file a return in time, which may result either in escape from taxes altogether or in making an inadequate assessment,

(viii) filing of a fraudulent, incomplete or inaccurate return,

(ix) keeping incomplete accounts and claiming erroneous deductions,

(x) filing appeals against assessments supported by false accounts[14],

(xi) inflating expenses, for example, charging expenses which, if incurred, could have been avoided by business prudence, or falsely showing expenses as incurred.

---

13. Report of the Taxation Enquiry Commission 1953-54, Government of India, Vol.2., para 4, p.190.
14. 'Incidence of Tax and Tax Evasion', Dr. Jacob Eapenn 2nd All India Conference of Tax Executives. 1967, F.I.C. C.I., p.7.

(xii) intentionally not maintaining any standard form of accounts and thereby concealing income,

(xiii) suppressing documents of sales and other transactions.

(xiv) purchasing tickets from the winners at race courses, gambling, betting and tote clubs, and turf accountants, for more than their face value. The purchaser of such tickets then asks the person liable to pay on the ticket to him by cheque so that he can claim that an excessively large amount credited to his account was due to 'gambling and betting gains', which are exempt from taxation.

(xv) purchasing restaurant bills for cash at a discount and then using them to inflate the expenses. The sum named in the bills is then withdrawn by the proprietor of the business for personal use.

(xvi) the endowment of a scholarship on condition that the individual's child is awarded that scholarship and that the school recoups the tax on the annual payment contracted for under the covenant[15].

As stated earlier[16] it is evident from a study of the history of taxation laws that tax evasion originated with the very inception of taxation. But the study reveals that its magnitude has increased tremendously in India during the last two and a half decades, i.e., since the second World War[17].

In fact, it is very difficult to ascertain accurately the exact amount of income-tax evasion in the

---

15. Tax Evasion and Avoidance: The Problem in the United Kingdom, A.R. Ilersic, (1954) 2, Canadian Tax Journal, pp. 378-379. The article narrates various types of tax evasion practices prevalent in the United Kingdom. They are illustrated under heads (xiv) to (xvi); The Royal Commission on Income Tax, Second Instalment of evidence, cmd. 288-2(1919), HMSO., London, Para 12,383(8), p.615. E. Standford, Deputy Chief Inspector of Taxes enumerates the following four methods usually adopted by taxpayers: (i) omitting to make returns, (ii) making incorrect returns, (iii) supplying incorrect accounts, or replying incorrectly to enquiries, i.e., accounts are manipulated, and are not correct copies of the taxpayer's own record, (iv) falsifying books. In many cases, although the books are correctly kept and the accounts furnished are correct copies of those appearing therein, it is found on investigation that the material items have been cancelled in the books themselves. See 'Tax Avoidance in India, R.K. Dalal and R.C. Cooper, (1953) 7 Bulletin For International Documentation, pp.5-6 for various types of tax evasion that are being practised in India.

16. See Chapter I, footnote 12.

17. The Problem of Tax Evasion: Report of the Indian Tax Reform, Nicholas Kaldor, Government of India (1956), para 183, p. 103.

country, because of the lack of any set and recognized principles of calculation. Nevertheless, various attempts have been made from time to time by officials as well as non-official bodies to ascertain the amount of tax lost through tax evasion. Perhaps the first bold attempt in this direction was made by Professor Nicholas Kaldor in the year 1956. He estimated the amount of Income-tax evasion in India as between Rs. 200 to Rs. 300 crores a year[18]. He made his statement on the basis of certain tentative figures relating to national income supplied to him by the Central Statistical Organization[19]. This figure included the amount of Income-tax lost through tax-avoidance as well[20]. The estimates given by Professor Kaldor caused a great uproar in the country and became the subject matter of much controversy and criticism. It was declared too high an estimate in various circles and based on mere conjecture[21]. However, Ursula K. Hicks, an eminent economist, not only supported Professor Kaldor's statement but estimated tax evasion in the country even higher.
She says:

---

18. Ibid.
19. Supra note 10, para 7.5, p. 148.
20. Ibid.
21. Ibid. Memorandum of Dissent, Comment and Recommendations, G.P. Kapadia, para 177-9, pp. 516-519.

> "The truth probably lies nearer the high figure, as suggested by Kaldor 200-300 crores, and indeed it may even be an understatement, since the figures on which Mr. Kaldor bases his estimate show the highest ratio of income disclosed to estimated income received in the category of income derived from trade, which are notoriously the most difficult to assess."[22]

As against Professor Kaldor's estimate, the Central Board of Direct Taxes calculated a leakage of revenue through tax evasion between Rs.20 to Rs. 30 crore a year[23]. whereas some of the eminent Indian economists, namely, Dr. C.D. Deshmukh, former Finance Minister, Government of India, estimated Income-tax evasion in the country around Rs.50 scrore a year[24]. Sriman Narayan, former member of the Planning Commission of the Government of India, as between Rs. 50 to Rs. 200 crore a year[25] and G.S. Sahota at the rate of Rs. 61 crore per year[26].

Though it is not possible to ascertain the exact amount of Income-tax evasion in the country, from the analysis of the above data, it stands out clearly and unambiguously that there is widespread tax evasion in India and the quantum of tax lost through evasion is quite high[27].

---

22. Mr. Kaldor's Plan for the Reform of Indian Taxation (1958) 68, The Economic Journal, pp. 160-161.
23. *Supra* note 6, para 6.2, p.106.
24. Indian Tax Structure and Economic Development, G.S.Sahota, Institute of Economic Growth (Bombay), at p.42.
25. 'Socialism in Indian Planning'(1964), p.41.
26. *Supra* note 24, p.50.
27. *Supra* note 10, para. 7.12, p. 150.
    supra note 12, chapter 12, para 2, p.189, *supra* note 24, p. 50.

The dimension of the problem can further be appreciated, if one looks into the amount of the concealed income unearthed by and disclosed to the Income-tax Department during the last two decades.

The first major and concerted effort of great significance in the direction of unearthing concealed income in India was done by the Income-tax Investigation Commission[28]. The Commission uncovered concealed income to the tune of Rs. 48 crores in cases referred to it by the Government of India under sections 5(1)[29] and 5(4)[30] of the Taxation on Income (Investigation Commission) Act, (30 of 1947), on which the tax evaded was Rs. 30 crores[31]. Similarly, the Income-tax Department during 1958-59 disclosed concealed income to the extent of Rs. 31.10 crores under section 34(1)(a) and (b)[32], of the Income-tax Act of 1922, which resulted in additional tax and penalties of Rs. 15.64 crores[33]. During the past four years from 1963-64 to 1966-67, the Income-tax Department detected a sum of Rs.80.76 crores of concealed income, on which Rs. 30.44 crores was imposed as penalty and additional tax[34].

---

28. See Chapter 2, supra, p.31 for establishment of Commission.
29. See Chapter 8, p.495 for section 5(1) of the Act.
30. See Chapter 8, pp.492-93 for section 5(4).
31. Supra note 6, para 6.4, pp. 106-107.
32. This section authorized the Income-tax Officer to assess income which escaped assessment or was under-assessed in the relevant assessment year. See Chapter II, p. for text of section 147, a corresponding provision in the Act of 1961.
33. Supra note 10, para 7.6, p.148.
34. Supra note 6, para. 6.4, p.107.

In 1951 the Government of India, with a view to uncover large sums of concealed income in the country, launched a Voluntary Disclosure Scheme, which was a new experiment in this direction, as a result of which concealed income to the tune of Rs. 70 crores was disclosed by 20,912 persons, on which additional tax and penalty of Rs. 11 crores was levied[35]. This scheme was somewhat akin to the 'confession' method adopted under section 105 of United Kingdom Tax Management Act of 1970[36] and the United States of America under section 3761 of the Internal Revenue

---

35. Supra note 10, para 7.6, p. 148.
36. Sec. 105 states that, (It corresponds to section 504 of the repealed U.K. Income Tax Act, 1952)
(1) Statements made or documents produced by or on behalf of a person shall not be inadmissible in any such proceedings as are mentioned in subsection (2) below by reason only that it has been drawn to his attention that -
(a) in relation to tax, the Board may accept pecuniary settlements instead of instituting proceedings; and
(b) though no undertaking can be given as to whether or not the Board will accept such a settlement in the case of any particular person it is the practice of the Board to be influenced by the fact that a person has made a full confession of any fraud or default to which he has been a party and has given full facilities for investigation. And that he was or may have been induced thereby to make the statements or produce the documents.
(2) The proceedings mentioned in subsection (1) of this section are -
(a) any criminal proceedings, against the person in question for any form of fraud or wilful default in connection with or in relation to tax, excess profits tax or the profits tax.
(b) Any proceedings against him for the recovery of any sum due from him, whether by way of tax or penalty, in connection with or in relation to tax.

Code[37] for arriving at compromise regarding tax liabilities. This scheme was much criticised by the public as well as various committees appointed by the Government to suggest measures for the elemination of tax evasion and tax avoidance[38]. They argued that it would amount to giving a premium on tax evasion and have the most destructive effect on tax morality[39].

However, the Government of India again in 1965, after a gap of fourteen years, introduced two Voluntary Disclosure Schemes, similar to that of 1951. The first

---

37. See 3761 of the Internal Revenue Code of 1954 says:
(a) Authorization - The Commissioner, with the approval of the Secretary or the Under Secretary of the Treasury, or of an Assistant Secretary of the Treasury may compromise any civil or criminal case arising under the internal revenue laws prior to the reference to the Department of Justice for prosecution or defence and the Attorney General may compromise any such case after reference to the Department of Justice for prosecution of defence.
(b) Redord - Whenever a compromise is made by the Commissioner in any case there shall be placed on file in the office of the Commissioner the opinion of the General Council of the Department of the Treasury, or of the officer acting as such with his reasons therefor, with a statement of -
(1) The amount of tax assessed.
(2) The amount of additional tax or penalty imposed by law in consequence of the neglect or delinquency of the person against whom the tax is assessed, and
(3) The amount actually paid in accordance with the terms of the compromise.

38. Supra note 10, para 7.79 at p.177
Supra note 17, para 203, p.113
) See supra note 12, pp. 341 to 346 for discussion of Voluntary Disclosure Scheme.

39. Ibid.

scheme was introduced by the Finance Act, 1965, and remained in force for a period of three months only. Within this short period, it brought into the open concealed income to the extent of Rs.52.19 crores, on which the tax came to Rs. 38.80 crores (calculated at the rate of 60 per cent). The number of persons who disclosed income was 2,001 and the average disclosure per assessee was Rs. 2,60,000[40].

Inspired by the success of the scheme, the Government introduced another Voluntary disclosure Scheme in the same year, i.e. 1965. Under this scheme 113,628 persons disclosed Rs. 145.51 crores of income on which the tax came to nearly Rs. 20 crores[41].

In addition to the above 1,900 persons made voluntary disclosure of Rs.21.76 crores of concealed income under the provisions of section 271(4A) of the

---

40. Supra note 6, para 6.5, p. 107,

41. Ibid.

Income Tax Act of 1961[42] which was added by S.3 of the Income Tax (Amendment) Act 1 of 1965, within two and a half years of its life, i.e., from April 1965 to December, 1967[43].

---

42. Income Tax Act, 1961, section 271(4A) authorizes the Commissioner to reduce or waive the minimum penalty imposed in the following cases, if the assessee:

    (i) has made voluntarily and in good faith disclosure of his income prior to the issue of notice under sub-section (2) of section 139, or prior to the detection of particulars of concealment of income as provided under clauses (a) and (c) of sub-section (1) of section 271 of the Act of 1961 (S.271(4A(ii)(a);

    (ii) has co-operated with the Revenue in an inquiry relating to the assessment proceedings (Ss.4A(ii)(b) and

    (iii) has paid or made satisfactory arrnagements for payment of tax and interest payable. (Ss.4A(ii)(c).

    In case the minimum penalty leviable exceeds Rs.50,000, the Commissioner can exercise his authority only with the previous approval of the Board of Direct Taxes (Proviso to Ss. 4A).
    The Commissioner's order under sub-section 4A shall be final and shall not be called in question before any Court of law or any other authority. (271(4B). However, the Commissioner's order may be called in question on grounds of law. A writ of certiorari under Articles 32 and 226 of the Constitution may be issued from the Supreme Court and the High Courts respectively, on the grounds of excess of jurisdiction or fraud or error of law, see '<u>Penalty Provisions under the Income Tax Act and Wealth Tax Act: Legal Aspects of Implications and Justification of Recent Changes</u>', R.S. Gae, 3rd All India Conference of Tax Exeeutives (1968) F.I.C.C.I., 103, 106.

43. <u>Supra</u> note 6, para 6.5, p. 107. The period is calculated from April 1965, when the Act was passed, to Dec. 1967, on the basis that the Report of the Working Group was published in January, 1968, in which reference has been given.

One remarkable feature of the 1965 Voluntary Disclosure Scheme is that it makes evident that the tax evasion is concentrated more in the upper income group of the business community as compared with the middle or lower income group in which it is relatively less. This is apparent from the fact that, in the first scheme, 2,001 persons made a disclosure of Rs. 52.19 crores giving an average of Rs. 2,60,000 per assessee, whereas in the second scheme 1,13,628 persons disclosed Rs. 145.51 crores, the average disclosure being only Rs. 12,850 per assessee[44].

All this goes to prove that a large sum of money is lying hidden in the country. Perhaps Samyukta Sadachar Samiti (1965) is right in saying that the quantum of unaccounted money in the country is approximately Rs. 3,400 crores[45]. In fact, it might be even more. This is supported from the fact that the Government of India could unearth a sum of Rs. 300.21 crores of concealed income within four years, i.e. from 1963 to 1967[46] even by adopting a lenient

---

44. Supra note 6, para 6.6, p. 107.
45. 'Problem of Unaccounted Money and How to tackle it'. Quoted from supra note 14, p.7. It does not appear clear from the statement whether the author meant by unaccounted money; unaccounted money as such, or unaccounted money in circulation as unaccounted income, or unaccounted taxable income. Perhaps it realtes to unaccounted taxable income.
46. See *supra* pp. 208-11 Income-tax Department detected Rs.80.76 crores during 1963-64. Voluntary Disclosure Schemes of 1965 uncovered Rs. 52.19 and Rs. 145.51 crores respectively and Rs. 27.76 was detected under the provisions of section 271(4A) of the Act of 1961. The total sum comes to Rs. 300.21 crores.

policy towards tax dodgers and granting them immunity from prosecution and punishment.

The Direct Taxes Administration Enquiry Committee, 1958-59, though it has not made an assessment of the unaccounted money in the country, appears to be well aware of the magnitude of the problem, in as much as it says, "there are large sums of evaded money kept underground"[47].

Thus it goes without saying that tax evasion is deeply rooted in India and is widespread on an alarming scale. It has become more or less a perennial problem to the economy of the country, and calls for constant and concerted efforts by all sections of the community[48].

It may not be out of place to mention here that it would be desirable for the Government of India, to instal a Commission on a permanent basis, independent of the Income Tax Department, to estimate the exact amount of tax evasion in the country and to pin point the potential areas or sections of tax evasion. This would give a correct estimate of tax evasion as against the conflicting estimates given by different bodies[49], which are neither authentic nor

---

47. *Supra* note 10, para 7.79 at p.177.
48. See *supra* note 12, p.329. Similar suggestions were made in regard to drive against tax evasion in the United States as long ago as 1946.
49. See *supra* pp. 204-206.

reliable. The estimate of tax evasion by an independent and impartial Commission would be more accurate and acceptable to all concerned, including the Income Tax Department.

This would help in ascertaining the most appropriate measures to be adopted against tax evasion and spotlight the various sectors for more effective examination. In this way, it would help to a great extent in restoring public confidence in the Income Tax Administration, which has been shaken by the almost total failure of the Department to check one of the most important economic crimes of the day, which affects the economic basis of the community.

The Commission could also be entrusted with similar assignments in regard to other direct and indirect taxes levied by the Government of India, which also require attention.

Social and Economic Consequences of Tax Evasion

The evils of tax evasion are many. It deleteriously affects the economy of the country, and has a number of other undesirable consequences. In fact, it would be a herculean task to enumerate and assess its total impact on Indian society. The impact of tax fraud is not confined to one particular area like other crimes, but is widespread. In other words, its influence on society is not only economic but social, moral, psychological and legal as well. As such, it would be difficult to make a thorough and detailed study of its various aspects. Perhaps a socio-psycho-legal study of the problem is required, which is beyond the scope of the present study.

However, an attempt is being made to point out some of the main effects of tax evasion on society and show its over-all impact. It may be discussed under the following heads.[50]

(i) Financial loss to the Exchequer,

(ii) demoralizing effect on the community,

(iii) inequality among taxpayers,

(iv) disrespect for law and the authorities,

(v) inflation of prices,

(vi) hoarding and black marketing,

(vii) corruption and graft,

(viii) evasion of other laws,

(ix) retardation of community's economic growth.

---

50. See Chapter 3 pp. 78-82 for effects of tax avoidance. They are applicable to tax evasion also.

From the foregoing discussions[51] it has become crystal clear that the Indian Exchequer is deprived of a large amount of revenue every year as a result of tax frauds[52]. This affects the economy of the State[53] as well as the normal growth and prosperity of the society by hampering and disrupting the State's commitments in its various economic and social welfare plans.

Tax evasion causes irreparable injury to public morals and public health. It brings about frustration amongst the people and has a demoralizing effect on an honest and law abiding citizen when he notices tax evaders getting honour and respect in the society. Tax evaders are not even treated as ordinary criminals, nor punished adequately. Rather they succeed in moving about in society as respectable and good citizens. A tax evader feels proud in evading taxes. There is no moral or social censure for his acts.

Tax evasion like tax avoidance brings about inequality[54] and thus cuts at the very root of the fundamental

---

51. See for loss of revenue due to (i) tax avoidance Chapter 3, pp. 79-80, (ii) tax evasion supra pp.204-13 and (iii) administrative delay in assessment and collection of taxes infra p.242 footnote 26.
52. Tax fraud in its wider concept includes loss of revenue through delay in payment of taxes, tax avoidance and tax evasion.
53. K.C.Pant, Minister of State in the Ministry of Finance, 2nd All India Conference of Tax Executives (1967), p.2.

54. See Chapter III pp. 78-82. for effects of tax avoidance.

principle of taxation, as it leads to unfair incidence of taxes in the community[55], because the honest and law abiding taxpayers are asked to bear and shoulder the heavy burden of dishonest taxpayers, who practise and adopt fraudulent and unfair means and tactics, finally succeeding in escaping payment of their just and due share of taxes. In fact, the tax dodger is an unmitigated nuisance and menace to society. The loss of revenue caused by his antisocial activities increases the burden of honest taxpayers.[56]

Tax evasion practised unchecked on such a large scale adds to the feelings of frustration of the honest taxpayers, places a premium on dishonesty and encourages a dangerous disrespect for taxation laws in particular and others in general. It shakes the faith of the masses in the custodians of the law on the basis of which the very fabric and the foundation of democracy exists.

Tax evasion leads to inflation of money in the market, because of the large sums of money in the hands of tax dodgers. Prices shoot up to the detriment of the common man. In fact, a handful of persons monopolize things and thereby regulate the market and prices to suit their own

---

55. 'Equality' is one of the four principles of taxation enunciated by Adam Smith in his book '<u>Wealth of Nations</u>' (1776) Vol. I, Book I, Chapter 6.
56. <u>Report of the Taxation Enquiry Commission 1953-54</u>, Vol.1V, (Evidence), Part II. Reply to the questionnaire by the Millowners Association, Bombay: Supplementary Information, pp. 342-343.

ends. At times they prevent competition by cutting down the prices and by not allowing the small enterpreneurs to participate. Mr. K.C. Pant, Minister of State in the Ministry of Finance, Government of India in his inaugural address at the 2nd All India Conference of Tax Executives (1967) is frank enough to admit that:

> "Unaccounted money had been responsible for aggravating inflation and rise in prices. Such money is not available for legitimate investment and invariably finds an outlet either in extravagant spending or in speculative ventures[57]".

Tax evasion leads to large scale hoarding of goods and making profit by selling articles at exorbitant rates when a shortage results. Crafty and cunning traders, taking advantage of the shortage of commodities, lacunae in the laws and lack of strict enforcement of the provisions of the law, invest the proceeds of evasion in hoarding goods and sometimes create an artificial scarcity. In this way, the chain of hoarding and black marketing goes on unchecked. Besides hoarding the goods of day to day necessities, the proceeds of tax evasion are also used in hoarding gold, jewellery and ornaments, kept in secret in their homes.

Tax evasion leads to corruption, in as much as unscrupulous tax dodgers utilize untaxed money in corrupting officials and staff of the Income Tax Department, in order

---

57. <u>Supra</u> note 53, p.2.

to get various undue concessions. The untaxed money is also utilized to corrupt public men, and political parties by making contributions to political funds and corrupting public servants.

Evasion of tax liability under the Income Tax Act also leads to evasion of tax under other Fiscal Statutes and vice versa. Because most of the Fiscal legislations, for instance, Income Tax, Sales - Tax Customs Act, Foreign Exchange Regulation Act and Import Trade Regulations Act are inter connected with each other, in the sense that evasion of tax liability under one affects the liability under another. For example, if a trader in order to evade sales-tax, reduces his business turn-over by Rs. 10 million a year, say by 50 per cent, that would automatically help him in evading income-tax, because his total mount of profit on which income tax would be payable is reduced by half, as the profits in a business are directly related to the turn-over.

Tax evasion leads to hampering the economic growth of the community, as tax evaded is generally kept concealed in the form of unaccounted money. This money is generally kept concealed and not brought into the open or invested in the market from fear of being detected and caught. As a result the economy of the State is adversely affected. It was rightly pointed out to the Direct Taxes Administration

Committee, 1956-59,

> "...If only this money could be brought to the open and made available for the development..., the economy of the country would benefit considerably"[58].

Causes of Tax Evasion - Defects in Legislation and Administration.

Various reasons are assigned for the large scale tax evasion in India. Perhaps it would be appropriate to discuss at the very outset the most debated point as regards the main causes of tax evasion. It is strongly argued in many quarters that tax evasion on such a large scale has been stimulated by the high rate of taxation, i.e. the higher the rate of taxation, the higher the rate of tax evasion[59]. This may be partially true, but it is not universally true. It is a recognized fact that no one would resort to tax evasion, unless it was profitable to him[60]. It would automatically stop, the moment the cost of evasion is higher than the gain from it. Had the above proposition,

---

58. Supra note 10, para 7.79 at p.177.
59. L.N. Birla, 2nd All India Conference of Tax Executives, (1967), para 12.3 at p.3; supra note 11 att pp. 1-2; 'The Investigative High Taxes Make Evasion and Inflation Inevitable',Kailash Khanna (1968), 4 C.T.B. 211; The Investigative Procedure for Criminal Tax Evasion', Joseph H. Murphy, 27, Fordham L.R. 48 (1958); supra note 13, para 3, p.9; supra note 56. Answer to the Questionnaire by the Bengal Chamber of Commerce, p.4. 'Taxation and Private Investment',National Council of Applied Economic Research, New Delhi, (1961), p.2.
60. Supra note 6, para 6.8, p. 108.

that the higher the rate of tax, the higher the rate of tax evasion, been correct, tax evasion would have been confined to the upper income group, where the rate of tax is high. But it is not so. Tax evasion is common to all classes of taxpayers, whether engaged in business or practising a profession or vocation, where the tax is directly collected from the assessee[61]. In fact, tax evasion takes place in the middle as well as the higher income group[62]. This is again supported by the result of the Second Voluntary Disclosure Scheme of 1965, in which all the individuals (belonging to the business community) who disclosed concealed income were from the middle and lower income group and not from the upper income strata as in the case of the First Voluntary Disclosure Scheme[63]. Of course, the intensity of the temptation to evade taxes is always more in the case of the upper income group, where rates are higher as compared with other groups of taxpayers, where the rate is lower. And so the concentration of tax evasion is obviously more in the former group than the latter[64]. But this is not because of higher rates of taxes necessarily; it may depend on the opportunities available for tax

---

61. See Chapter 6, pp. 264-65 for modes of collection of tax. To talk of tax evasion in the case of the salaried class of people or wage earners, where the tax is deducted at source before it reaches the taxpayer's pocket, is futile. See <u>supra</u> note 14, para 4, p.7.
62. First Five Year Plan, Government of India, Chapter III, para 13.
63. <u>Supra</u> note 6, para 6.5. at p. 107.
64. <u>Supra</u> pp. 212-13.

evasion, which are more in the former group than the latter. This is because the taxpayers in the upper income group can more successfully manipulate things in their favour[65] and employ the best brains to assist them[66], not only in their anti-social activities but also in criminal acts of tax evasion.

No doubt taxation beyond the saturation point is not good for the economy, because it retards growth. Taxes beyond an accepted limit should not be imposed. But tax rates are not to be blamed for high rate of tax crimes[67]. In fact, the fault lies elsewhere.

An attempt has been made in the foregoing pages to illustrate some of the important causes of tax evasion[68].

---

65. See Chapter I, footnote 8.
66. '<u>The Attitude of the Legislature and the Courts to Tax Avoidance</u>', G.S.A. Wheatcroft (1955) 18, Mod L.R. 209, at p.212.
67. <u>Supra</u> note 6, para 6.8, at p. 108, <u>supra</u> note 10, para 7.8 at p.149.
68. <u>Royal Commission on the Income Tax: Second Instalment of the Minutes of Evidence</u>, Cmd. 288-2 (1919) HMSO., London, para 12, 37 (1), p. 615. The report states four main causes of evasion. They are (a) fraud, (b) wilful witholding or misstatement of material facts, (c) ignorance or carelessness, and (d) legal avoidance. '<u>The Investigative Procedure for Criminal Tax Evasion</u>', Joseph H. Murphy, 27, Fordham L. Rev. 48 (1958). Some of the reasons stated for tax evasion are: High tax rates, prosperity, inflation and larceny.

They are as follows:

(i) Complexities in the tax laws,

(ii) the absence of deterrent punishment,

(iii) the harassment of the taxpayers,

(iv) the lack of publicity of the names of tax evaders,

(v) inefficient tax administration,

(vi) lack of integrity of the income tax staff ,

(vii) inadequate prosecution machinery,

(viii) shortage of experienced personnel; and inadequate staff,

(ix) lack of a proper system of assessment and collection of taxes,

(x) absence of co-ordination with other tax departments,

(xi) lack of adequate legal advice on potential prosecution cases,

(xii) evasion of other taxes,

(xiii) absence of a legal requirement to keep books and accounts in a standard form,

(xiv) low public morals and absence of social consciousness,

(xv) inflation and unstable economy,

(xvi) operation of controls and inadequate enforcement machinery,

(xvii) lenient judicial attitude towards tax evasion[69].

The law of Income Tax in India is complicated, intricate, technical and difficult to understand,[70] like British Income Tax law[71]. A brief examination of the present Income Tax law discloses how sadly hopes of our earlier days have been frustrated. The remarkably ingenious Income Tax Act of 1886, containing but fifty sections has gradually grown to the astronomic number of three hundred sections and sub-sections. Sections and sub-sections often seem so intermingled as to cause a strain to the eye and a puzzle to the brain. The Act lacks the characteristics of the ideal statute which should have simple provisions, predictable consequences and be susceptible of easy and effective

---

69. See following sources for causes of tax evasion: supra note 6, para 6.9, pp. 108 to 111; supra note 10, paras 7.8 to 7.17. pp. 149 to 151; Report on Tax Administration in India: A Tax Assistance Survey, Foreign Tax Assistance Staff: U.S. Internal Revenue Service: USAID; India (1964), p.6. Supra note 15, pp. 379 to 381 (deals with U.K. laws); Ceylon: Report of the Taxation Commission, 1955, paras 357 to 359, pp. 249,250; Legislative measures to Fight Tax Fraud in Norway, Kristian Stangeby, Oslo, (1953)7, Bulletin for International Fiscal Documentation, p.262; The Struggle against Tax Evasion: The Situation in Denmark, S. Hiort-Lorenzen, President of the National Taxation Appeal Tribunal in Denmark, (1953) 7, Bulletin for International Fiscal Documentation, pp. 10 to 12; 'The Investigation Procedure for Criminal Tax Evasion', Joseph H. Murphy, (1958), 7, Furdham L. Rev. 48; See supra note 14, p.11.
70. Supra note 10, para 7.9, p. 149.
71. 'Tax Reforms which Could be Worked', W.J. Horner, Former Tax Inspector, HMIR (U.K.), 'The Guardian', December 9, 1969, p.14.

administration[72]. As a result an average man of ordinary intelligence can hardly follow the provisions of the Act.

It would not be an exaggeration to say that Income Tax return forms in India are so complicated and obscure, that even a law graduate can hardly file a correct income tax return, with the result that one is compelled to seek the advice of legal experts and pay them a considerable sum by way of remuneration, in addition to the tax payable to the Income Tax Department. So ingeneous taxpayers attempt to reduce the amount of legitimate tax due by resorting to fraudulent practices. At times some of the experts aid and abet their clients in the crimes of tax evasion and play the role of middle-men between tax dodgers and unscrupulous officers of the Income Tax Department[73]. This is, in fact, a slur on the noble profession of the law and an act of shame by those who regard themselves as the custodians of civilization[74]. This undesirable act on the part of the professional men can be checked only if they are subjected to prosecution, as in the United States of America.[75] Similarly, Morarji Desai, ex-Finance Minister and

---

72. 'Some Iconoclastic Reflections on Tax Administration.', Louis Eisentein, (1945) 58 Harv. L.R. 477, at p.482.
73. Supra note 10, para 8, 133, p. 237.
74. 'Conduct at the Bar and Some Problems of Advocacy', J.E. Singleton, K.C. (1969), p.1.
75. Supra note 12 at p. 336; see 'Legal Ethics and Professionalism,(1970) 79 Yale L.J. 1179; "The Role of the Lawyer in Administartive Justice", Harry Whitmore (1970) 33 Mod. L.R. 481-498.

Ex. Deputy Prime Minister of India, while giving evidence before the Select Committee on the Income Tax Bill, 1961, said that:

> "It is the help given by the expert which is responsible for a lot of evasion. Therefore he requires to be more severely punished."[76]

Tax advisers, lawyers and accountants should stick to the advice adduced by Howe P. Cochran - a Washington attorney in advising their clients. He states:

> "If your client has made some money, or if he expects to make some money and his hopes are later realized, let him pay his taxes, and you; and let him go out and earn some more money, so that he may pay some more taxes and some more to you. Such a course is far more profitable to him than wasting time and money in schemes to defeat his taxes."[77]

There is no dispute over the point that adequate punishment for the violation of the law is the only remedy and is essential to protect society from falling into disrepute and chaos. As stated by Manu, the Great Hindu law giver:

> "Punishment governs all mankind; punishment alone preserves them; punishment wakes while their guards are asleep; the wise consider the punishment as the perfection of justice"[78]

---

76. '<u>Evidence</u>', Select Committee on Income Tax Bill, 1961, (Government of India), p.207.
77. '<u>Tax Avoidance Schemes End in Disaster</u>', Howe P. Cochran, (1951), 5 Miami L.Q. 435, '<u>The Responsibility of Tax Adviser</u>' Randolph E. Paul (1950) 63 Harv. L. Rev. at p.377.
78. '<u>Institutes of Hindu Law or the Ordinances of Manu</u>', translated from the original by G.C. Haughton, Professor of Hindu Lierature in the East India College, London (1825) Chapter VII, para 18, p. 189.

Thus persons guilty of tax crimes, like other criminals should be punished adequately[79], according to the gravity of the offence, to deter them from repeating it and at the same time setting an example to others who are like minded[80]. As stated by Aristotle, 'Punishment is a sort of medicine[81]. But to one's great surprise in India the tax-dodgers are treated very leniently[82]. One would perhaps not believe that hardly a dozen prosecutions for fraudulent evasion of taxes wotth the name have taken place in India since the enforcement of Income tax legislation. Prior to 1939, the Income Tax Department used to resort to prosecution in some cases of tax frauds[83], but from 1939 to 1960 hardly a single prosecution was launched, as no data are available for that period. This attitude of indifference and apathy on the part of the Department is a direct inducement to commit tax frauds. Not only this, but taxpayers are generally promised complete protection both from publicity and prosecution, if they are ready to pay a modest penalty[84]. In fact, a nominal monetary penalty or even

---

79. Supra note 56. Mill Owners Association, Bombay, p.340, S. Vaidya Math Aiyer and Co., Delhi, p.486.
80. P.D. Patel v. Emperor A.I.R. 1933 Rangoon 292, 294; Queen v. Roland Bertrand (1967) 67 D.T.C. 5245.
81. 'Crime without Punishment: A Psychiatric Conundrum', Edward De Grozie,(1952), 52 col. L.R. 746.
82 Supra note 17, para 202, at p. 113.
83. Supra note 10, para 7.12, p. 150.
84. Supra note 17, para 202, p. 113.

a short term of imprisonment would not deter tax evasion, if the tax evaded were large[85]. The Income Tax Department was the subject of vehement criticism for its inactivity by various bodies[86]. But it had no effect on the working of the Department, as is apparent from the following data available of prosecutions in tax fraud cases from 1961-62 to 1965-66. The Income Tax Department does not initiate prosecution, even in cases where tax evasion is fully established[87]. The figures of prosecutions for the years 1961-62 to 1965-66 are as follows:

---

85. '<u>Bias Against Tax Evaders</u>': The Economic Weekly, (Bombay) September 27, 1958 at p. 1234.

86. <u>Supra</u> note 10, para 7.12, p. 150; <u>supra</u> note 6, para 6.9, pp. 110,111;
The Public Accounts Committee, 21st Report (1963-64) - Third Lok Sabha remarked:
In para 7.12 of its report, The Direct Taxes Administration Enquiry Committee observed that though the Direct Taxes Acts provide for prosecution and imprisonment in the cases of concealment of income, not a single person has been convicted for evasion during the last ten years, and recommended that unless it was brought home to the potential tax evader that attempts at concealment of income would not only not pay him but also actually land him in jail, there could be no effective check against evasion. The Committee are not a little surprised to find that, even though this recommendation has been accepted, Government sent for prosecution not more than one person in the whole of the country during 1961-62 and that case too was compounded.

87. <u>Supra</u> note 6, para 6.9 (f) at p. 121.

Table No.1 : Criminal Proceedings in India[88]

Number	Year	Number of cases in which prosecution was launched.	Number of cases which resulted in conviction.
1	1961-62	1	Nil
2	1962-63	2	2
3	1963-64	Nil	Nil
4	1964-65	28	Nil
5	1965-66	Nil	Nil

Thus during a period of five years the Income Tax Department launched 31 prosecutions for tax evasion and got 2 persons convicted. This needs no further comment.

The position is similar in the case of administrative penalties levied by the Income Tax Department for defaults committed under the provisions of the Act[89].

---

88. Ibid.
89. Ibid. The Income Tax Department imposed a penalty for deliberate concealment of income under section 271 (1) (c) of the Act, only Rs. 11.58 crores for a period of five years, i.e., 1962 to 1966. This might appear a big sum, but it works out to be even less than 15 per cent of the concealed income when law provided at the relevant time for the imposition of a minimum penalty of 20 per cent and maximum of 150 per cent. Now the minimum penalty has been raised to 100 per cent of the amount of concealed income. See Chapter VI for provisions relating to administrative penalties.

It may not be out of place to mention that even in Britain where a lenient attitude is discernible against tax evaders, a considerable number of prosecutions do take place every year. The following data from 1959-60 to 1968-69 would justify the statement:

Table No. 2 : Criminal Proceedings in Britain[90]

Number	Year	Number of cases in which prosecution was launched	Number of cases which resulted in conviction.
1	1959-60	102	100
2	1960-61	132	130
3	1961-62	151	147
4	1962-63	120	115
5	1963-64	168	163
6	1964-65	139	130
7	1965-66	133	127
8	1966-67	141	134
9	1967-68	94	87
10	1968-69	122	115

From the analysis of the above data it emerges that, out of 1248 prosecutions launched for various

90. 112th Report of the Commissioners of Her Majesty's Inland Revenue for the year ended 31st March, 1969, Hundred and Twelfth Report, H.M.S.O., London, p.49, Table 26.

categories of tax crimes for the years 1959-60 to 1968-69, the revenue got 1194 of them convicted, which comes to more than 95 per cent of convictions. This clearly indicates that the Revenue in the United Kingdom is more vigilant in launching prosecutions in cases of tax crimes. Such cases are thoroughly processed and scrutinized and the Revenue leaves no stone unturned in getting tax dodgers prosecuted.

Tax criminals in the United States of America are dealt with even more severely than in the United Kingdom. The taxpayer in America, unlike those in Britain and India, is left to assess his income himself and pay tax accordingly and if he is found guilty of concealment of income, is fined heavily. In addition to a penalty, the assessee is prosecuted, and this generally results in a long term imprisonment[91]. For example, the Inland Revenue Service in 1964 and 1965 recommended prosecutions to the extent of 1032 and 1218 cases respectively[92]. The number of

---

91. Supra note 17, para 204, p. 114. Prof. Kaldor cites two cases to show the extent to which prosecution provisions are resorted to in the United States. During the 2nd World War the Vice President of one of the biggest New York Banks, the National City Bank and the Chairman of the New York Stock Exchange, were prosecuted for tax evasion and much publicity was given to it. In 1956 the head porter of the Waldorf Astoria Hotel in New York was prosecuted for concealing a sum of 27,000 dollars earned in tips. He disclosed 33,000 dollars whereas he earned 60,000 dollars in tips.
92. 'Prosecution for Attempts to Evade Income Tax' A Discordant View of a Procedural Hybrid', Steven Duke, 76 Yale. L.J., p.1, at p.34 (1964): 'Current Problems in Tax Fraud Field', Paul P. Lipton, (1965) Wis. L. Rev. 41, ' 'Policies and Procedure in Income Tax Fraud Cases', Turner L. Smith, 21, Tenn L.R. 498 (1950).

convictions has steadily increased. The total number of convictions, which was 2,900 only from 1930 to 1952 went up to 7,035 within a period of eleven years, i.e. from 1953 to 1964. Similarly, the number of convictions increased from year to year. In 1958, the number of convictions were 492 only; it went up to 552 in 1962 and to 607 by 1964[93]. The position in Norway[94], Denmark[95] and other countries is similar, where penal and prosecution provisions are frequently resorted to in tax fraud cases.

It may be noted that the policy of leniency would be inappropriate in a developing country like India, where a large number of taxpayers are not willing to fulfil their obligations. A.M. Nremner while giving evidence before the Royal Commission on Income Tax in 1920, rightly stated:

> "The real way to prevent fraud ... is that fraud should be punished by terms of imprisonment; that is the way to stop it. It will never be stopped in any other way; the temptation is so great now. People must be made to understand that if they defraud the revenue, they are committing a mean and despicable offence against every one of their fellow taxpayers."[96]

---

93. Ibid p.70.
94. Legislative Measures to Fight Tax Frauds in Norway, Kristian Stangeby, Oslo, (1953) 7 Bulletin for International Fiscal Documentation, p. 258.
95. 'The Struggle Against Tax Evasion in Denmark', Hiortlorenzen, (1953), 7 Bulletin for International Fiscal Documentation, p. 13.
96. Supra note 68, para 16,028, at p. 800.

It is an undisputable fact that, for a successful tax administration, there must be mutual trust and co-operation between the Income Tax Department and the assessee. But contrary to this a sceptical and inquisitorial attitude is generally displayed by the taxing authorities which creates an undesirable gulf between the taxpayer and the tax collector. The very first reaction of a taxing authority to a taxpayer is that he is a tax dodger, whether he is or not. The integrity of the bulk of the majority of taxpayers is unquestionable[97]. As a result the Department's attitude is biased from the very start and the assessing officers do not accept the assessee's return, even if it is correct and the assessee produces evidence in its support[98]. This creates a feeling of dissatifaction amongst the taxpayers and they start understating their income, wealth, etc., knowing that it will be increased by the Income-tax Officer.

In fact, the conduct of an Assessing Officer should not be that of a tax-grabber but that of a referee, standing between the State on the one hand and the taxpayer on the other hand, with the sole idea and desire that both parties should get a square deal. The assessees are often required to appear before the Income Tax authorities. They are asked to wait outside the Income Tax Office and to

---

97. Supra note 10, para 7.16, p.151.
98. Supra note 56. Reply to the questionnaire by Bombay Shareholders Association, p.261.

come in their turn. To ones great surprise, they wait from morning until the office closes and are then told to come again on some other day and so the chain goes on. It is a great pity that the Income Tax authorities do not take any notice of the inconvenience caused to a taxpayer by this waste of his time and energy. After all, it is the taxpayer who is the pay master and contributes to the coffers of the State and not the Income Tax Department. The authorities must take due regard of the assessee's time, convenience and provide proper facilities. It is noted with surprise that at some places the Department does not even provide a proper place for the taxpayers to sit.

Sometimes persons are made to suffer for non-observance of minor technicalities of law, which are not even required. Perhaps an illustration would be appropriate to elucidate the point. A taxpayer who was an employee in the University was going abroad for a short period. Being a law abiding citizen he thought he needed a Tax Clearance Certificate before leaving the country. Accordingly he approached the appropriate Officer for the purpose. To his great surprise he had to run to the Income Tax Office several times before he could get it. The work could have been done within five minutes. In fact there was no need of a Tax Clearance Certificate[99] in his case, as he was going abroad for a limited period on leave from the University, which he should have been told by the Tax Recovery Officer. This shows the utter ignorance of the provisions of law by even senior officials of the Department.

These acts of harassment and arbitrary disposal of assessment cases embitter good relations between the authorities and the taxpayer. Taxpayers remain dissatisfied with the Department's working and with the attitude of the staff. He gets a bitter experience on his very first visit and an impression is created in his mind that honesty does not pay in dealing with the Income Tax Department. Mistrust begets mistrust and a vicious circle is created. As a result the taxpayer starts non-co-operation with the Department, becomes hostile and finally indulges in fraudulent tax evasion[1], which ultimately pays him. The Income Tax Investigation Commission (1949) has rightly analysed the problem. The Commission says:

> "It is evident...that a strong feeling of distrust and discontent exists in the public mind against the administration of income-tax in this country. So long as this feeling persists, various types and forms of evasion are likely to thrive."[2]

---

99. Income Tax Act, 1961, section 230 requires only two classes of persons leaving India to procure a Tax clearance certificate, namely,
(i) where the person is not domiciled in India, and
(ii) where even if domiciled at the time of departure, has no intention of returning to India.
See '<u>The Law and Practice of Income Tax</u>', J.B. Kanga and N.A. Palkhivala, (1969), Vol.I at p. 950.
1. <u>Report of the Income Tax Investigation Commission (1949)</u> Government of India, para 357, p. 157.
2. <u>Ibid</u>.

It is high time for the Income Tax authorities to change their attitude of bias and ill feelings towards taxpayers. The authorities should treat taxpayers as their friends and take into consideration their genuine grievances, and difficulties and remove them, as far as possible. Taxpayers should be told of their responsibilities to the State. They should be made to feel proud of their contributions to the economy of the State however small it may be. This will establish a feeling of trust and confidence in the Income Tax Department and will help taxpayers in disclosing their correct income voluntarily on which the effective administration of income tax rests[3].

In fact, there should be more friendliness of manner, gentle treatment of the small fry, and more vigorous pursuit of the big fish. But it is found otherwise. Small traders and taxpayers are harrassed whereas big persons are left free. This will not help the Department in establishing good relations with taxpayers.

There can be little doubt that public censure and public exposure of an individual's wrong doing through the modern media of communications, i.e., the press, radio

---

3. '<u>Incidence of Tax and Tax Evasion</u>', K.C. Khanna, 2nd All India Conference of Tax Executives (1967), pp.3,4.

television and cinema is one of the most potent and recognized forms of deterrent in the present era of social consciousness. The very fear of being exposed to the public acts as a deterrent against a crime. The publication of the names of delinquent assessees, i.e., those convicted of tax crimes as well as those fined by the Income Tax Department is essential to a successful plan of control of tax crimes[4]. However, the policy of the Government of India appears to be otherwise in this regard. This is apparent from the statutory provisions in the Income Tax Act in this connection. The Income Tax Act of 1922 had no provision for the publication of the names of such persons[5], instead the Department was statutorily prohibited from doing so[6].

---

4. Supra note 10, para 7.13, p. 150;
supra note 56, p.456;
'Evading Tax Evasion': Economic Weekly, (Bombay), Sept. 24, 1960, p. 1422.
Report of the Taxation Enquiry Committee: Kenya: 1947, Printed by the Government Printer, Nairobi, para 136, pp. 42-43.
Indian Taxation Enquiry Committee (Tod Hunter Committee), para 250 quoted from supra note 13, para 249, p.111; see supra note 85, p. 1234

5. In 1960 section 59A was inserted in the Act of 1922 by s.9. of the Taxation Laws (Amendment) Act, (280 of 1960), with effect from 1st April, 1960 which authorized the Central Government to publish the names in certain cases.

6. Supra note 10, para 7.13, p. 150

However, the Income Tax Act of 1961, under section 287[7] has made a half-hearted attempt in this direction. The section authorizes the Central Government to publish the names of the assesses and any other particulars, if the Government considers it appropriate and the public interest demands it.

It may be noted that the original section 287[8] of the Income Tax Act of 1961 was more pragmatic and potent, as compared with the present section, which is more or less ineffective. According to section 287 it was obligatory on the part of the Central Government to publish the names of assessees where a penalty over Rs. 5,000 was imposed or a conviction was made under section 271[9], or 277[10] of

---

7. Income Tax Act, 1961, sec. 287 says:
"(1) If the Central Government is of opinion that it is necessary or expedient in the public interest to publish the names of any assessee , and any other particulars relating to any proceedings under this Act in respect of such assessees, it may cause to be published such names and particulars in such manner as it thinks fit."
This section was substituted for the original section 287 by the Finance Act (5 of 1964), with effect from April 1, 1964.
8. The impugned section 287 of the Act of 1961 provided that;
"(i) The Central Government shall cause to be published by notification in the Official Gazette, the names and such other particulars as may be relevant of -
(a) persons on each of whom a penalty amounting to not less than five thousand rupees ... has been imposed under clause (c) of sub-section (1) of section 271, and
(b) persons who have been convicted as a result of any proceedings under section 277 or under any provisions of the Indian Penal Code ... for any offence connected with any proceedings under this Act."
9. See Chapter VI, pp. 286-87 for section 271.
10. See Chapter VII, pp. 398-99

the Income Tax Act, 1961, or under any provisions of the Indian Penal Code took place[11], whereas the present section leaves everything to the discretion and good sense of Government officials. One wonders whether this lenient attitude on the part of the Government will help in curbing tax crimes. Publication should not be left so much to the discretion which in practice can mean the whim or arbitrary choice of the officials.

It may be pointed out that the provision for publicity of the names of tax evaders is well recognized and practiced with good results in most other countries, viz., Australia[12], United States of America [13], Kenya[14], New Zealand[15], Norway[16] and various other countries of the

---

11. The impugned section 277 in sub-section (4) empowered the Government to refrain from publishing the names of persons if it was in the interest of revenue. But the reason for not publishing the names was to be recorded in writing.
12. Supra note 1, para 249, p.111.
13. American Public Finance, Shultz, 3rd ed. p. 329. Quoted from supra note 93, para 250, p.111;
14. Taxation Enquiry Commission, Kenya, 1947, para 136, p. 42.
15. Taxation of Income in New Zealand, G.A. Lau, Bulletin for International Documentation, Vol. IX, (1955), p. 270.
16. Supra note 94 Section II, p. 258.

world. The Seminar on the Administration of Income tax in African countries, organized under the auspices of the United Nations (during March 15 to April 5, 1968) has gone to the extent of suggesting the publication of the list of all taxpayers[17]. It may not be out of place to quote a reply received by the Income Tax Investigation Commission (1949) to the questionaire issued by it as regards the feasibility of publicity provisions in the Income Tax Act. It is as follows:

> "The penalty and public exposures which should be applied to those who deliberately cheat should be of utmost severity. The result of this would be that merit would attach to those who pay their just dues."[18]

An efficient tax administration is essential for a successful programme to eradicate tax crimes.[19] As pointed out by Schultz, an American writer on public finance:

> "A haphazardly run office can no more be successful in its operations than a carelessly conducted business enterprise. If evasion is not to be widespread and if the taxpayer's money is not to be wasted in inefficient tax assessment and collection, a technique of tax administration must be developed."[20]

---

17. Report of the Seminar on Administration of Income Tax in African Countries, United Nations (1968), para 43, at p.11.
18. Supra note 13, para 248, at p.111.
19. 'Simplification and Rationalization of Income Tax Law: A Study: Federation of Indian Chambers of Commerce and Industry, (1965), p. 68.
20. Supra note 13, para 357, pp. 156, 157 (quoted).

This is true of the Indian Income Tax Department[21]. The Department lacks zeal and enthusiasm even in its day to day work, to say nothing of detection of fraud cases. The Report on Tax Administration in India has made a very pertinent remark of the working of the Income Tax Administration in India. The report says that:

> "The Income Tax Officers, as a matter of practice, seldom leave their desks in search of evidence of tax evasion. They tend to rely on relatively untrained inspectors to secure such evidence from records of the assessee and others, including banks."[22]

This view is strengthened by the small number of prosecutions launched every year by the Department, in cases of clear and glaring tax evasion in the country.[23] The Department should launch a vigorous scheme to audit accounts thoroughly, as it is done in the United States of America[24] and prosecute tax evaders without respect of persons

21. The Problem of Tax Evasion: Report of the Indian Tax Reform, Nicholas Kulador (1956), p. 114.
22. Report on Tax Administration in India: A Tax Assistance Survey by the Foreign Tax Assistance Staff: U.S. Internal Revenue Service: USAID, INDIA 1964, p.17.
23. See supra pp. 228-29.
24. Internal Revenue Service audits three to four million tax returns per year and from this mass it selects approximately one thousand taxpayers whom it recommends to the Justice Department for prosecution. During 1965, the Internal Revenue audited 3,268, 000 income tax returns, and out of this number 584,000 were audited in field audits, and the remainder in the office audit. (1965 Commissioner's Inland Revenue Report, p. 23).

at least for the time being. This will help to a great extent in curbing tax evasion.

In the case of assessment and realization of taxes the Department's role is unique. It is a matter of common practise of the Income Tax Department that delays are made in the assessment proceedings - sometimes for as long as 3 to 4 years. At the end of the limitation period, assessments are rushed through with a speed which appears to the taxpayers to be capricious[25]. This leads to a feeling of injustice in the minds of an assessee. It is a well known proverb that justice should not only be done but it must appear to have been done. It is not sufficient to do justice, but the tax paying public must be made to feel that justice is done. Similarly, the Department has not been able to collect millions of tax already assessed and lying in the hands of the taxpayers as arrears[26]. A lot of time is wasted in looking for petty additions on account of minor disallowances with no advantage to the revenue.

---

25. Supra note 56. Answer to Questionnaire by the Madras Chamber of Commerce, p. 173.
26. The total amount of income tax (including corporation tax) realized for the year 1966-67 was Rs. 500.33 crores as against Rs. 541.73 crores lying outstanding in arrears. In addition a sum of Rs.90 crores owed to the Government is lying in the hands of the assessee on account of administrative delay in the assessment of cases in time. See Audit Report (Civil) Revenue Receipts, Government of India (1968), pp. 59,61.

Though it would be too much to say that the entire Income tax administration is corrupt, it would not be an exaggeration to say that there is a strong feeling in the public mind that the staff lacks the integrity required of it, which is partly responsible for large scale tax evasion [27]. The Committee on Prevention of Corruption has analysed the various forms of corruption prevalent in the Income Tax Department[28]. The Committee is of the view that there are two main ways of corruption in the Department, firstly by intentionally showing undue favour to assessees in relation to - assessments, penalties, appeals, recovery of taxes, refunds, procedural tactics, tampering with records, miscellaneous; and secondly by deliberately causing unnecessary harassment in order to take illegal gratifications from taxpayers[29]. It may be noted that highest standards of integrity, honesty and fair play are essential for successful tax administration. As pointed out by the Direct Taxes Administration Committee:

---

27. Report of the Direct Taxes Administration Enquiry Committee, 1958-59, para 7.17, p. 151.
28. Report of the Committee on Prevention of Corruption (1964) (Government of India), pp. 266-273.
29. Ibid. p. 267; see for details of the scope for corruption at the different levels pp. 266 to 271.

> "Not only should the Department officials be honest but they must also be above suspicion and that they should so conduct themselves in their private as well as official life that no wrong motives could be attributed to any of their actions."[30]

The very nature of fraud cases being complicated, their detection requires an efficient well equipped and properly organized machinery for investigation and prosecution of tax offences. However, not much emphasis is put on this side in India. Although there are three agencies[31] in the country to investigate and prosecute cases of tax fraud, but hardly any tax-dodger is severely punished. It is not because tax evasion has not taken place, but because the officers responsible for the detection of tax fraud cases do not take sufficient interest in the investigation and prosecution of such cases. Firstly, the officers who are entrusted with such work at the level of Central Commissioner of Income Tax and Territorial Commissioner of Income Tax are already overburdened with their day to day work and hardly find time to pay proper heed to the cases of tax fraud[32]. Secondly, they lack the proper training in investigation techniques, collection of

---

30. Supra note 27, para 7.17, p. 151.
31. The three agencies responsible for investigation and prosecution of tax offences are:
    (1) The Directorate of Inspection (Investigation).
    (2) The Central Commissioners of Income Tax.
    (3) The Territorial Commissioners of Income Tax.
32. Supra note 27, para 7.69, at p. 172.

evidence necessary to substantiate a charge and court procedure. As a result most of the tax fraud cases are not made out and even in cases where the Department initiates proceedings against tax-dodgers, it results in acquittal[33]. In brief the procedure adopted in the case of tax evasion at different agencies are as mentioned.

The Directorate of Inspection (Investigation) undertakes the responsibility for the investigation of very few cases of tax frauds of a complicated nature , in which a substantial amount of tax is involved. The 'Investigation Wing' of the Directorate collects information relating to evasion in cases referred to it and prepares cases for prosecution. A separate wing known as the 'Intelligence Wing' is attached to the Directorate, for the purpose of undertaking investigation in difficult and complicated cases and to render guidance regarding methods of examination of accounts etc.[34]. In the offices of the Central Commissioners of Income Tax (which are four in number at Delhi, Calcutta, Madras and Bombay) and in these of territorial commissioners of income tax, tax fraud cases are prepared and investigated by senior officers of the

---

33. See <u>supra</u> p.229.
34. <u>Report of the Working Group: Central Direct Taxes Administration</u>, Administrative Reform Commission (1968) para 6.25, at p. 121.

Department. After investigation the case is sent for prosecution with the approval of the Commissioner of Income Tax for the division.

It is at the level of Commissioner that emphasis is needed. In fact, a separate Department should be opened in every Commissioner's jurisdiction to investigate flagrant cases of tax fraud and prepare them for prosecution. The officers appointed in the Department should be well versed in income tax law, criminal law and the techniques of investigation. They should be given intensive practical training in the techniques of investigation and preparation of cases. A suggestion somewhat similar to this was made by the Direct Taxes Administration Enquiry Committee; 1958-59[35], but the Government did not pay any attention to it. It is time the Government took a constructive step in this direction and instructed the Income Tax Department to initiate prosecutions in cases of tax evasion instead of imposing a penalty.

It may be noted in this connection that in the United Kingdom[36] and the United States of America[37] tax

35. Supra note 27, para 7.69, at p.172.
36. Supra note 27, at p.3 of the chapter, para 7.65 at p. 170.
37. The Law of Federal Income Taxation; John C.Chommi (1968), p. 673;'Tax Fraud and Evasion', Balter, 3rd ed. (1963), Chapter 3; 'Prosecution for Attempt to Evade Income Tax: A Discordant View of a Procedural Hybrid', Stevens Duke, (1966) 76, Yale L.J., pp. 34-75; 'Penalties and Prosecutions for Evasion of the Federal Income Tax', Gerald L. Wallace (1946) I Tax L.R. 329 at pp. 338-44.

evasion cases are thoroughly scrutinized, prepared by a well trained staff and an attorney of the Tax Division in the Department of Justice. This ensures a great number of successful prosecutions in tax fraud cases, so that tax evaders think twice before indulging in the vicious act of evasion.

It may be useful to give in brief an account of the system of investigation of tax crimes in the United States, to show how much emphasis is placed on such cases. The investigation of criminal fraud and other potential violations of the revenue laws is conducted by special agents from the Intelligence Unit of the Treasury Department of the District concerned. After a thorough investigation of a suspected case of evasion, the special agent submits his report to the superior officer in the Unit for approval. If the report is approved, the file is transmitted to the Penal Division in the office of the chief counsel of the Bureau of Internal Revenue. In case the Penal Division approves prosecution, the case is transmitted by the Commissioner to the Assistant Attorney General in charge of the Tax Division in the Department of Justice to launch a criminal prosecution. The cases are thoroughly scrutinized again in the Department by an attorney in the criminal section of the Tax Division, and the Assistant Attorney General finally decides for or against the prosecution.

It is after such a thorough scrutiny at various levels that the prosecution is launched. This ensures 100 per cent chance of conviction by the court.

Other Causes of Tax Evasion

Since the last World War the number of taxpayers has increased nearly seven times.[38] Within the period of six years from 1961-62 to 1967-68 the number of taxpayers has increased from 12 lakhs to approximately 27 lakhs, and the revenue has gone up from Rs. 322 to Rs. 630 crores[39]. This increase is bound to continue in coming years and an increase in revenue is necessary for a developing country like India. But to one's great surprise the atrength of the Income Tax Department has not increased in proportion to cope with the magnitude of the work. For instance, the number of officers entrusted with assessment work was 744 in 1944-45 and 1,648 only in 1966-67. The number of officers has doubled but the increase in the number of assessees is sevenfold[40]. As a result many tax fraud cases go untraced and undetected, a large number of assessments

---

38. Supra note 34, para 2.3 pp. 10,11.
39. 'Tax Payer Education', F.H. Vallibhoy, Member, Central Board of Direct Taxes, Government of India, Report on the 3rd All India Conference of Tax Executives, (1968) F.I.C.C.I. p.125.
40. Supra note 34 para 2.3 p. 10.

remain pending for years[41] and a huge sum of tax money is left unrealized[42]. One can appreciate the heavy burden imposed on the Income Tax Officers by the fact that each Officer is required to assess and audit an average of more than one thousand cases per annum, besides shouldering many other responsibilities, which is evident from the following data of disposal of income tax assessment from 1959-60 to 1966-67.

---

41. Audit Report (Civil) Revenue Receipts, Central Government, (1968), Government of India, para 58, p. 59. 23.48 lakhs of cases were outstanding with Income Tax Officers pending assessments. It is estimated by the Ministry of Finance, Government of India that the approximate amount of tax involved in these cases is about Rs. 90 crores.

42. Ibid. para 59, p. 61. The total outstanding demand of tax on 31st March, 1967 was Rs. 541.73 crores.

Table No. 3.

Analysis of Disposal of Income Tax Assessments[43]

Serial No.	Year	Average Disposal per Income Tax Officer
1	2	3
1	1959-60	939
2	1960-61	963
3	1961-62	1,008
4	1962-63	1,003
5	1963-64	1,113
6	1964-65	1,293
7	1965-66	1,543
8	1966-67	1,467

The problem needs a careful study and immediate action is necessary, if tax frauds are to be minimised and checked. As noted by Professor Kaldor:

> "... The prevention of evasion is very greatly dependent on the standard of administration in the Revenue Department - on the zeal, ability, efficiency, and adequacy of number of tax officers. An efficient administration requires the ability of the Department to attract the best talents and to attract them in adequate numbers."[44]

---

43. Supra note 34, p.11.
44. 'The Problem of Tax Evasion: Report of the Indian Tax Reform, Nicholas Kaldor (1956) at p. 114 (para 205)

The machinery for assessment, collection and recovery of taxes in India is very intricate, cumbersome and defective. As a result, considerable sums of taxes remain in arrears[45], either because of delay in assessment or delay in collection and realization, and ultimately a substantial portion goes underground and becomes untraceable[46]. Again a large portion of assessees income escapes untaxed, due to the lack of proper vigilance on the part of the Income Tax Department and carelessness in making assessments. For example, a test audit, conducted during the period from September 1, 1966 to August 31st, 1967, revealed a total under-assessment of tax of Rs. 1179.98 lakhs in 9469 cases[47]. One would be amazed to note that in 687 cases out of those 9467 a shortage of levy amounting to Rs. 1088.94 lakhs were detected[48]. This means that there was an average under-assessment of approximately Rs. 1.6 lakhs in each case. This was the result of the following lapses on the part of the Income Tax Department[49]:

---

45. Supra note 41 at p. 61, para 59, the report reveals that a sum of Rs. 541.73 was the amount of tax in arrears for the year 1966-67.
46. See supra note 68.
47. Supra note 41, para 40(i), p.38.
48. Ibid.
49. Ibid, para 40 (ii), p.39.

Table No. 4.

No.	Nature of the Lapses	Amount in lakh of Rs.
1.	Errors and omissions attributable to negligence or failure to apply the correct rate of tax.	33.99
2.	Incorrect computation of income under the head "salary"	3.11
3.	Incorrect computation of income under the head "house property"	3.55
4.	Incorrect computation of income from "business"	91.86
5.	Under-assessment arising from wrong computation of development rebate and depreciation.	41.94
6.	Irregular exemption from tax of newly established industrial undertakings or hotels	9.22
7.	Incorrect allowance of rebate of tax in relation to exports	1.33
8.	Other irregular exemptions or excess reliefs	294.56
9.	Incorrect computation of super-tax/income tax payable by companies	29.20
10.	Non-levy of additional super-tax/ income-tax under sections 23 A/104 of I.T. Act, 1922/1961	36.22
11.	Non-levy/incorrect levy of penal interest	40.48
12.	Mistakes committed while giving effect to appellate orders	3.02
13.	Income escaping assessment	83.50
14.	Incorrect determination of super-profits tax or sur-tax.	5.97
15.	Other lapses	502.23

From the above statistics one can appreciate the gravity of the lapses in assessment on the part of the Income Tax Department and the amount of loss of revenue to the exchequer every year. It opens one's eyes when they reveal the fact that under-assessment to the tune of lakhs of rupees has taken place in individual cases. This is the result of the scrutiny of only a few hundreds out of the lakhs of cases assessed every year by the Income Tax Department. It is clear that millions of rupees go unassessed in India every year. This is a serious problem that needs a concerted effort by the Government and the Income Tax staff.

The first and foremost requirement in this direction is, perhaps, as stated by the Royal Commission of Taxation of Profits and Income, 1955, that:

> "To prevent evasion of tax it is necessary to secure that each taxpayer's tax is (a) properly assessed, and (b) properly paid."[50]

This requires simplification of the tax law[51], the introduction of simpler return forms, proper and timely assessment of taxes, an efficient and trained staff, proper auditing and checking and strict supervision by the superior officers over the acts of their subordinates.

---

50. Royal Commission on the Taxation of Profits and Income, 1955. H.M.S.O., Cmd. 9474, para 1050, p.319.
51. Supra note 34, pp. 59-75.

In big cities like Bombay, Calcutta, Madras and Delhi computers and other associated apparatus such as automatic data and processing machines, as used in the United States of America[52], should be introduced for calculation of income, allowances and deductions. This will ensure quick disposal of cases of assessment and minimize chances of error.

As pointed out earlier most taxes[53] are inter-related, so that evasion of one tax directly or indirectly leads to the evasion of the other tax. Thus it is necessary, in order to check tax evasion effectively, that a system of liason with other Central as well as State revenue Departments should be made for the exchange of relevant information from one Department to the other. This was suggested by the Taxation Enquiry Commission in its report in 1953-54[54]. But it has not come into practice so far.

The Income Tax Officers, except in places like Bombay, Calcutta, Madras and New Delhi, do not have adequate facilities to obtain proper legal advice on potential tax fraud cases[55]. Income Tax Officers are authorized to consult only those attorneys, who represent the Central Government

---

52. 'Taxation in the United States: World Tax Series; Harvard Law School; International Program in Taxation (1963), para 2/6.4 page 144.
53. See supra, p. 219.
54. Vol.II, Chapter XII, para 13, p. 193; supra note 17, para 42, p.11.
55. Supra note 22, para 6, p.47, supra note 54, para 6.26 at p. 121.

in State Courts, irrespective of their knowledge of the intricacies of the Income Tax laws. Income Tax law being one of the most complicated and specialized branches of law, it is not possible for every lawyer to give proper advice in cases of tax evasion. As a result either no prosecution against tax-dodgers is iniated or, if launched, results in acquittal. This directly encourages potential tax evaders. It is essential that provision for adequate legal advice be made; it might be better to appoint one good tax lawyer in every District to represent the Income Tax Department in income tax cases.

The average man does not want to part with his earnings, and is encouraged to avoid payment of taxes, because taxpayers get no benefit above those enjoyed by persons who do not pay taxes[56], and this becomes more conspicuous, when the taxpayer disagrees with the policy pursued by the Government and when he notices that tax criminals are exempt from liability to pay[57] taxes and are not prosecuted for their evasion[58]. Even honest taxpayers start evading taxes.

It is, therefore, necessary that taxpayers should be made to realise that they owe a duty to the State to pay taxes. At the same time strict action should be taken against tax evaders to restore a sense of justice amongst

56. _Supra_ note 94, p.262.
57. See Chapter I, footnote 8.
58. _Supra_ note 34, para 6(a)(f), pp. 110, 111.

the public.

The Indian Income tax[59] like the British Income tax[60] does not impose any legal obligation on assessees to maintain books and records of income. The assessee is not obliged to verify the figures that he writes in his returns by the production of vouchers, records or accounts. However, section 145(2) of the Act of 1961, empowers the Income Tax officer to make a best judgement assessment[61] in two cases, viz., where assessee's accounts are incorrect or incomplete, or where no method of accounting has been regularly employed by the assessee[62]. Assessment on the basis of estimate is merely guess work, and unless it is above the assessee's real income, in which case the assessee goes to appeal, his true income may go unassessed for years. One can appreciate the difficulty of the Income Tax Officer in verifying the return submitted, in the absence of any authentic document. Of course, the Income Tax Act, 1961, under section 145 clause (1)[63], enacts that, if the assessee maintains records in accordance with the method of accounting regularly employed

---

59. Supra note 22, para 8, p.17.
60. Supra note 50, para 1051, pp. 319,320.
61. See Chapter II, pp. 51-54 for best judgement assessment.
62. Supra note 99, p. 741. There was no such provision in the earlier Act of 1922. Some of the traders keep two sets of records, one for the Income Tax Department and the other for their own use. The first one mostly gives a false picture of earnings while the second one gives a correct picture.
63. Income Tax Act, 1961, section 145(1) corresponds to section 13 of the Income Tax Act, 1922.

by the assessee, in cases of income from profits of business, profession or vocation under section 28[64] or income from other sources under section 56[65] of the Income Tax Act, 1961, the income, profits and gains must be computed on the basis of the accounts maintained. The Income Tax Officer can refuse to rely on the accounts only if the true income, profits and gains cannot properly be deduced therefrom[66].

But as the maintenance of records is optional, most traders, particularly small ones, prefer not to keep any record at all, rely on the Income Tax Officer's assessment and thus escape payment of the whole tax due. As suggested by the (U.K.) Royal Commission on the Taxation of Profits and Income (1955), in its final report, a legal duty should be imposed on every person who carries on a trade, profession or vocation to keep records in a standard form[67]. Similar provisions are to be found in the Internal

---

64. Income Tax Act, 1961, section 28 states the items of income chargeable under the head 'Profits and gains of business or profession'. The section corresponds to section 10(1) of the Act of 1922.
65. Income Tax Act, 1961, section 56 (which corresponds to section 12 of the Act of 1922) deals with residuary head of income and states that every income which is not to be excluded from the total income shall be chargeable under the head 'Income from other sources'. Nalini Kant Ambalal Modi v. Narayan-Row A.I.R. 1967 S.C. 193.
66. C.I.T. v. Sarangpur Cotton Manufacturing Co. (1938). I.T.R. 36,40 (P.C.).
67. Supra note 50, para 1052, p.320. Sir James Martin, while giving evidence before the Royal Commission on the Income Tax, said that:
"It should be incumbent upon all persons engaged in trade or business to keep such books of accounts as are usual and proper in the business carried on, and as will sufficiently disclose the business transactions and financial position." CMD. 288-2 (1919) H.M.S.O. para 5213-5, see chapter VII.

Revenue Code in the United States of America[68]. This would help to a great extent in ascertaining the true income and check evasion.

Since the last World War, due to the impact of industrialization, urbanization and mass movement, a new materialistic philosophy has gripped the nation. The theme of this new philosophy is that material advancement is the only important matter in life and, in achieving it, one need not hesitate to adopt unethical behaviour. For instance unscrupulous traders never hesitate to do business not recorded in their account books[69] and thus evade taxes. Similarly, some purchasers do not demand cash memos[70] and get opportunities not only to evade sales tax but income tax as well.

People in India do not regard tax evasion as reprehensible as violations of other economic statutes[71], or crimes against property, such as theft, robbery, cheating, embezzlement etc.[72] Tax evaders are not treated as ordinary criminals and are not punished adequately. Instead they are accepted in society as respectable and good citizens, and

---

68. United States Internal Revenue Code, 1954-S.6001.
69. '<u>Socialism in Indian Planning</u>', Srimannoroyan (1964), p.42.
70. <u>Supra</u> note 27, para 7.14, p. 150.
71. '<u>Criminology</u>', P. Goswami, Kitab Mahal, (Allahabad), pp. 260-261.
72. <u>The Crime of Income Tax Fraud: Its Present Status and Function</u>', Charles Lyton, (1953) 53, Col. L. Rev. 476, at p. 480.

a man who behaves honestly and pays his due is considered stupid by all successful people[73]. Such a social attitude is conducive to tax evasion[74]. The more a person evades tax, the more he is regarded as crafty and intelligent; his status is judged by the amount of tax evaded[75]. The Income Tax Investigation Committee rightly said in its report that:

> "As things are at present, there is no question but that those who are known to be the biggest deliberate taxation cheaters are received in all ranks of society in the country and by virtue of their very success in cheating are surrounded with an aura of ability and shrewdness instead of being ostracised and stamped with obloquy. There can be no public consciousness in the matter of taxation as long as these conditions obtain."[76]

It is high time for the people in general and the business community in particular to abandon the present materialistic approach and realize their social and ethical responsibility. It will be appropriate to quote a passage from Manu Dharma Sastra with regard to the standard of conduct required of the business community. Manu says:

> "The possessive instinct need not be so blind as to make one callous in the mad lust for wealth. Occupation should be socially useful, morally uplifting. One need not take up a task that militates against social and personal welfare, nor should the body be abused. Desire for wealth must not be allowed to become a mania and defeat its own purpose. Values cannot be divorced from economic pursuits. A Vaisaya (merchant) should not, for the sake of his substance, follow evil ways. He should live a pure, straightforward honest life of a Brahmin type."[77]

---

73. Select Committee on the Income Tax Bill:,(1961) Morarji Desai, 1961 (Lok Sabha) Evidence, p.116.
74. Supra note 34, para 6.19 (e) at p.110.
75. Supra note 43, p.3.
76. Supra note 1, para 248, p. 111.
77. 'Manu Dharna Sastra', Kewal Mutwani, Published by Ganesh & Company, Madras., p.125.

As a result of large scale inflation and unstable economic conditions in the country, the prices of goods have gone up and are going up every day. The currency has gone down in value and will probably depreciate in future as well. This encourages the desire for tax evasion, for the profits of tax evasion today may be invested so as to compensate for the falling value of currency[78]. For example, if a person conceals Rs. one million due as tax and purchases property with this money in 1971, the same might be worth double the amount within ten years, due to inflation of prices. It is for the Government to check inflation by adopting a sound policy and enforcing the provisions of law strictly so that economy of the country may become stable and the tendency to evade taxes may be checked.

No doubt, India has striven hard, since the achievement of political freedom in 1947 and the emergence of free India as a sovereign democratic republic in 1950, to achieve economic independence , but it has not been successful as yet. The country has to go a long way before it can achieve economic independence in the real sense of the term. There is always a scarcity of some goods. It may be in food grains, baby food, fuel, building materials, vehicles, conveyances and a number of other goods in daily

---

78. Supra note 3, p.2.

use. The Government, with a view to protecting the interests of the common man, imposes statutory controls to check prices and ensure a regular supply of such goods. But unscrupulous traders take advantage of the situation. They sometimes create an artificial scarcity in the market by hoarding goods and thereby prices of goods shoot up beyond one's imagination. In this way a huge sum of money is earned by traders and is made in the black market every year[79]. They keep no account of such sales, because their earnings are illegal and would lead to prosecution, if recorded in account books. The income remains unrecorded and no tax is paid on it.

This can be checked only by strict enforcement of the control provisions and adequate punishment in appropriate cases, as suggested by Dr. Radha Krishnan, the Second President of the Indian Republic. He said that:

> "The practitioners of this evil, the hoarders, the profiteers, the black-marketeers, and speculators are the worst enemies of our society. They have to be dealt with sternly, however, well placed important and influential they may be; if we acquiesce in wrong doing, people will lose faith in us." [80]

---

79. Supra note 34, para 6.09 (d) at p. 130.
80. 'Hazards of Food Adulteration: Souvenier', Seminar organized by the Bharat Sewak Samaj, New Delhi (2nd to 4th Oct. 1964), p.1.

CHAPTER VI

ADMINISTRATIVE SANCTIONS

Interest

Having discussed tax evasion in Chapter 5, it is proposed to discuss, in this and the next chapter, the legislative provisions enacted from time to time, to facilitate the proper assessment of taxable income[1], and to ensure proper compliance with the statutory obligations[2].

The Indian legislature appears to have realized, from the beginning of Income tax legislation[3], the necessity for coercive measures to prevent tax crimes[4] and to compel delinquent taxpayers to fulfil their obligations to the State on the one hand, and to encourage the taxpayers' honesty and to overcome his distaste for the payment of taxes on the other hand. The coercive measures[5] in brief, include imposition

---

1. Maraddi Krishna Reddy v. I.T.C., Tenali A.I.R. 1957 A.P. 368 at p. 369 (para 6).
2. Roscoe Pound, 'Jurisprudence', Vol.V. (1953), p. 200, 'An obligation is a bond of right and law by which we are bound by a necessity of performing some act according to the law of our State.'
3. As early as 1869, when the Income tax law in India was in its initial stage, the Act of 1869 in section 25 provided a penalty of failure to pay tax after due notice.
4. See Chapter 7 p.344 for different types of tax crimes.
5. See Chapter 5, pp207-11 for persuasive measures. Some of these measures are programme to educate taxpayers, to give incentive to those who pay taxes in time.

of interest, fine and imprisonment. The quantum of the penalty is determined according to the nature and gravity of the default[6]. The sanctions provided under the Income Tax Acts may be imposed by two different and independent agencies, viz., the revenue authorities and the criminal Courts[7]. Sanctions may therefore be broadly classified into two categories[8], namely, administrative sanctions, and criminal sanctions.

The administrative sanctions are those which are exercised by the revenue authorities in case of defaults committed by a taxpayer[9]. The Indian Income Tax Acts like

---

6. R. Prasad Mohanlal v. Income Tax Appellate Tribunal A.I.R. 1970 All 620 see p. 625 (F.B.).
7. See Income Tax Act 1961, section 292. Offences under the Act could be tried either by a presidency magistrate or a magistrate of the first class. There are five categories of criminal courts, namely, Courts of Sessions, Presidency Magistrate, Magistrate of the first class, the second class and the third class. See Code of Criminal Procedure (5 of 1898), section 6.
8. C.I.T., Calcutta v. Anwar Ali A.I.R. 1968 (Cal). 345, 352: The sanctions provided for various defaults in relation to tax crimes in the United Kingdom, United States of America, Canada, Australia are classified into (i) civil and (ii) criminal. The former are enforceable by revenue authorities and the latter by criminal courts. See 'Fraud and Federal Income Tax in the United States', Harold M. Groves and Arthur M. Selle (1955) 7, Bulletin for International Fiscal Documentation 321, 322. 'Income Tax Penalties', Emanuel L. Gordon (1944) 5 Tax L.R. 131. In Japan the penalties are divided into (i) Administrative and (ii) Judicial penalties. 'An Outline of Japanese Taxes, Chapter 14, para 19/1 at p. 139.
Halsbury's Laws of England (Simond's Edition), 3rd ed. Vol. 20, p. 715.

the statutes of the United Kingdom[10] and the United States[11], have provided two types of administrative sanctions, namely interest[12] and penalty.

The Income Tax Act has made provisions for imposition of interest as the first measure to encourage prompt payment of taxes. The Act provides for the levy of interest in the following four cases:

(a) Failure to deduct or pay tax,
(b) failure to file return of income,
(c) failure to pay tax on demand, and
(d) failure to pay advance tax.

The Act provides two modes of collection of taxes, namely, collection at source, and direct collection from the assessee[13]. A salary[14], interest on securities[15] and

---

10. The Taxes Management Act, 1970, provides for 'Interest on Overdue Tax' in Part 9 (sections 86 to 92) and 'Penalties' in Part 10 (sections 93 to 106).
11. Inland Revenue Code, 1954, in section 6601 (a) provides for imposition of interest and in sections 6651 to 6681 for imposition of penalties.
12. 'Interest' has been defined in the Chamber's Twentieth Century Dictionary, as 'premium paid for the use of money' (1968 Imprint), at p. 553.
13. Purshottamdas Thakurdas v. Commissioner of Income Tax, Bombay City, A.I.R. 1963 S.C. 1066, 1068; 'The Law and Practice of Income Tax', J.B. Kanga and N.A. Palkhivala, (6th ed. Vol.I, Bombay), p. 899. See 'Deduction of Tax at Source, P.L.Jaitly, 4th All India Conference of the Tax Executives (1969) p. 190.
14. Income Tax Act, 1961, section 192 (= Income Tax Act 1922, section 18(2). See 'Deduction of Tax at Source' A.K. Bose. 4th All India Conference of Tax Executives, (1969), p. 173.
15. Income Tax Act, 1961, section 193 (= I.T.A., 1922 sec. 18(3)D.

dividends[16], tax is deducted at source, before it reaches the hands of the earner. The person responsible for payment of such amounts deducts the tax due at the time of payment at the rates fixed in the Finance Act of the relevant year[17]. Such deduction of income tax is treated as payment of income tax on behalf of the person from whose income the deduction was made[18] and credit is given to him at the time of the regular assessment[19]. Whereas, in cases where tax is not deductible at source, as in cases of non-recurring earnings, such as income from a business, profession or vocation, or where tax has not been deducted at source, as required under sections 191, 202 and 205 the income tax is directly collected from the assessee[20]. Section 200 of the Act imposes an obligation on the part of the person deducting the tax to pay the amount due to the

---

16. Income Tax Act, 1961, section 194 (=I.T.A., 1922, sec. 18 (3D). In C.I.T., Calcutta v. Nalin Behari Lall A.I.R. 1970 S.C. 388, Shah, Acting C.J., defines 'dividend' at p. 389 (para 3) as follows:
" 'Dividend' in its ordinary connotation means the sum paid to or received by a shareholder proportionate to his share-holding in a company out of the total sum distributed."
See C.I.T., Madras v. M.V. Murugappan and others A.I.R. 1970 S.C. 1712, 1713.
17. 'Income Tax for the Layman, The Directorate of Inspection, 6th edition, (1966), p. 85.
18. Income Tax Act, 1961, section 198.
19. Income Tax Act, 1961, section 199.
20. Income Tax Act, 1961, section 191.

credit of the Central Government or as directed by the Board of Direct Taxes within the prescribed time. If such person does not deduct the tax, or, after deduction, fails to pay the tax, as required under the Act, he is deemed to be an assessee in default under section 201(1), and is required to pay simple interest at nine per cent[21] per annum on the amount of such tax from the date on which such tax was deductible to the date on which such tax is actually paid, under sub-section 1A of section 201 of the Act[22].

As stated earlier[23], sub-section (1) of section 139 of the Act of 1961 makes it obligatory on the part of every person, whose total income during the previous year exceeds the taxable income to furnish a return of his total income not later than June 30 of the assessment year. The Income Tax Officer has been given power to extend the period for submitting the return in genuine cases up to a certain period on an application being made, without charging any interest[24]. But no further extension of time is admissible under the Act, unless the assessee is willing to pay interest at the rate of nine per cent, as required under clause (iii) of sub-section (1) of section 139 of the Act. However, to moderate the rigours of law, the Act has given power to the Income Tax Officer to waive or reduce the amount of

---

21. 'Nine' was inserted for 'six' by the Taxation (Amendment) Act (27 of 1967) with effect from October 1, 1967.
22. Inserted by the Finance Act, 1966.
23. See Chapter II, pp. 47 to 48.
24. Income Tax Act, 1961, section 139 (1)(i) and (ii).

interest under sub-section (8) of section 139[25] read with rule 117A[26] of the Income Tax Rules, 1962, in appropriate cases.

Sub-section (1) of section 220 of the Income Tax Act, 1961, provides that any tax, interest, penalty, fine or any other sum mentioned in a notice of demand[27] must be paid within 35 days of the service of the notice, unless a shorter period is specified by the Income Tax Officer[28]. Sub-section (2) of section 220 provides for the imposition of interest in case of failure to pay tax as required under sub-section (1). Sub-section (2) states that:

---

25. No such provision was in the repealed Income Tax Act, 1922.
26. Income Tax Rules, 1962, section 117A, provides five cases in which the Income Tax Officer may reduce or waive the interest payable under section 139. These circumstances are:
(i) where the return of income is furnished by... an agent of a non-resident and is assessed in respect of the latter's income;
(ii) where the return of income is furnished by an assessee whose only source of income during the relevant previous year is a share in the income of an unregistered firm...;
(iii) where the return of income of a deceased individual is furnished by his legal representative and ... he had reasonable cause for not furnishing such return within time;
(iv) where the return of income has been furnished in pursuance of a notice issued under section 148;
(v) Any case in which the assessee produces evidence ... that he was prevented by sufficient cause from furnishing the return within time."
27. Income Tax Act, 1961, section 156 authorizes the Income Tax Officer to issue a 'notice of demand'.
28. Income Tax Act, 1961, section 220(1) 'proviso' authorizes the Income Tax Officers to reduce the period of 'notice of demand', if necessary in the interest of the revenue.

"... the assessee shall be liable to pay simple interest at nine per cent per annum from the day commencing after the end of the period mentioned in sub-section (1)."

The Interest is payable in addition to the penalty under section 221 of the Act[29].

The tax is levied on the total income of the previous year at the rate or rates prescribed in the Finance Act of the year. In other words, tax is paid in each year upon the income received in the previous year[30]. This creates two problems. Firstly, it places persons whose taxes are collected at source at a disadvantage compared with those who pay tax directly. Taxpayers in the first category, pay tax in the year in which it is earned, whereas taxpayers in the latter category, pay tax in the following year, and enjoy the use of money due to the State, which is not available to those whose taxes are collected at source. Secondly, the State is deprived of the use of revenue accrued to it, on the income already earned by taxpayers.

The Income Tax (Amendment) Act, (11 of 1944)[31] for the first time made provision for payment of tax in advance by inserting section 18 A in the now repealed Act of 1922. This provision was made applicable to taxpayers, who paid tax directly to the State where the total income exceeded

---

29. See <u>infra</u> p.335 for provisions relating to section 221.
30 <u>'The Law and Practice of Income Tax'</u>, J.B. Kanga and N. A. Palkhiwala, (6th ed., 1969), Vol.I, pp. 923.
31. <u>Chockalingam and M. Mayyappan</u> v. <u>C.I.T., Madras</u> A.I.R. 1963 S.C. 1456, 1457 (para 5; <u>'Advance Tax - Legal & Procedural Problems'</u>, S. Srisivasar, 4th All India Conference of the Executives, p. 185.

the maximum amount not chargeable to tax by two thousand five hundred rupees[32]. Section 18 A, was probably inserted in the Act of 1922, not to wipe out the discrimination between the two classes of taxpayers, but as one of the anti-inflatory measures made necessary by the Second World War,[33] to combat inflation and to reduce the huge sum of money then in circulation [34]. Sections 207 to 219 of the Income Tax Act, 1961, have reproduced the provisions in regard to advance payment of tax contained in section 18A of the repealed Act of 1922, with slight modifications. These provisions are based on the 'pay as you earn' system', i.e. paying tax by instalments in respect of the very year in which the tax is paid, as the income is received[35].

Section 208 of the Income Tax Act, 1961, requires every person, whether assessed previously[36] or not[37], whose

---

32. Income Tax Act, 1922, section 18A(1)(a).
33. '<u>The Law of Income Tax in India</u>', V.S. Sundaram (7th ed.) 1954, at p. 759.
34. <u>Purshottamdas Thakurdas</u> v. <u>C.I.T</u>. A.I.R. 1963 S.C. 1066 1069.
35. <u>Ibid</u>. Similar system is in practice in the United Kingdom, '<u>Advance Payment of Tax</u>', B.L. Kabra, 4th All India Conference of Tax Executives (1969), p. 177.
36. Income Tax Act, 1961, section 208 (2). The section has been substituted for the old section by sec. 12 of the Finance Act (14 of 1969) with effect from April 1, 1970. Formerly the maximum amount was fixed at Rs 2,500 for every one.
37. Income Tax Act, 1961, section 212(3).

total income [38] for the latest assessment year, exclusive of capital gains[39], exceeds:

(a) in the case of a company or a local authority Rs. 2,500;

(b) in the case of a registered firm... Rs. 30,000;

(c) in the case of a person other than a company, a local authority or a registered firm, -

(i) where such person was not resident in India during the previous year... Rs. 5,000;

(ii) in any other case ... Rs. 10,000[40]
to pay tax in advance in the financial year.

The advance tax is calculated on the basis of the regular assessment completed for the latest preceding year as provided under sub-section (a) of section 209[41]. The Income Tax Officer, where a person has been previously assessed, passes an order under section 210(1) and issues a 'notice of demand' to the assessee specifying the

---

38. Income Tax Act, 1961, section 2 (45) states that 'total income' means the total amount of income referred to in Section 5, computed in the manner laid down in this Act.
39. Income Tax Act, 1961, section 45(1) provides that: "Any profits or gains arising from the transfer of a capital asset effected in the previous year shall,... be chargeable to income tax under the head 'Capital gains', and shall be deemed to be the income of the previous year..."
40. Income Tax Act, 1961, section 208 (2).
41. Income Tax Act, 1961, section 209 provides the method for the computation of the amount of advance tax payable by an assessee.

instalments in which tax is payable[42]. The Act does not permit the postponement of the dates of instalments of sdvance payment of tax. However, section 213 grants a concession to as assessee. An assessee may defer payment of advance tax on that part of his commission, which has not been received or adjusted in the assessee's account by the time the instalment of tax becomes due. This has perhaps been done to avoid hardships caused to an assessee in such cases. In the absence of such provision, an assessee would be required to pay tax on that part of income, which has not been received at the time of payment of tax. But immunity from non-payment of tax on commission is not unfettered. The assessee must pay tax within fifteen days of the receipt of such commission or adjustment in his account. In case of failure to deposit the tax, the assessee would be liable to pay simple interest at nine per cent per annum from the date of such receipt or adjustment to the date of payment of the advance

---

42. Income Tax Act, 1961, section 211(1) which has been inserted by section 15 of the Finance Act (14 of 1969) states:
"(1) ...[A]dvance tax shall be payable in three equal instalments on the following dates during the financial year, namely:-
(i) the 15th day of June, the 15th day of September and the 15th day of December, in the case of an assessee whose total income to the extent of 75 per cent thereof or more is derived from a source or sources for which the previous year ... ends on or before the 31st day of December;
(ii) the 15th day of September, the 15th day of December, and the 15th day of March, in any other case". Formerly the provision was for four equal instalments.

tax[43].

If a person has not previously been assessed by way of regular assessment, he is required to submit an estimate of his income to the Income Tax Officer and pay tax accordingly. Section 212 makes provision for making an estimate of one's income and payment of advance tax in two cases. Firstly, where an assessee, who is required to pay advance tax by an order issued by the Income Tax Officer under section 210, considers that his total income is likely to be less than, or more than, what has been estimated by the Department[44]. Secondly, where the assessee has not previously been assessed[45]. This provision has been provided

---

43. Income Tax Act, 1961, section 213 'Proviso'. Income Tax Act, 1961, section 214 (1) like the corresponding provision of the Act of 1922, as provided in section 18A(5) provides for payment of 'interest' by the Government to an assessee on the aggregate sum of advance tax paid in excess over the amount determined on regular assessment.
44. Income Tax Act, 1961, section 212 (1). It was added by S. 16 of the Finance Act (14 of 1969) with effect from April 1, 1970.
45. Income Tax Act, 1961, section 212 (1) (= analogous to Income Tax Act, 1922, section 18A(2)). Section 212(2) provided for revised estimate of advanced tax. A.K. Bashu Sahib v. I.T.O. , (1967) 66 I.T.R. 20(Mad). The estimate of tax must be sent to the Income Tax Officer on the prescribed form before the date on which that instalment becomes due. If the estimate is not sent before the date on which an instalment becomes due and the assessee did not pay the advance tax as per demand, he is treated in default as regards such instalment.

to mitigate the hardships caused to assessees in genuine cases, where the assessee is required to pay more than what would other wise be due.

The Act requires fair play on the part of the assessee as well. If the advance tax paid by the assessee, on the basis of the estimate made by him turns out to be less than 75 per cent of the tax calculated[46] on regular assessment[47], the assessee would be liable to pay simple interest at the rate of nine per cent per annum[48] on the difference between the tax due on regular assessment and the tax paid in advance.

However, in case of a hardship, the rigour of the law is mitigated by the discretionary power given to the Income Tax Officer under sub-section (4) of section 215 and sub-section (2) of section 217 of the Income Tax Act,

---

46. Income Tax Act, 1961, section 215(1). In the earlier Act of 1922, the assessee was allowed a margin of "twenty per cent", only under section 18A(6). Balmer Lawrie and Co. Ltd. v. C.I.T., Calcutta A.I.R. 1960 Cal. 360, para 4.
47. Income Tax Act, 1961, section 2(40) states that: "regular assessment" means the assessment made under section 143 or section 144. See Purshottam Thakurdas v. C.I.T. A.I.R. 1963 S.C. 1066. An assessee need not include 'dividend' in the estimate of income for the purpose of payment of advance tax.
48. See *supra* note 21. An assessee would be liable to a penalty as well in certain cases for failure to pay advance tax under section 273 of the Act of 1961. See *infra* pp.326-28.

1961[49] read with rule 40 of the Income Tax Rules, 1962.

Before the introduction of section 212 (3A)[50], an assessee was not liable to pay any interest, if the advance tax was paid on the Income Tax Officer's order under section 210, even if the tax calculated on the regular assessment was found to be much higher than the tax demanded. But now, after the insertion of sub-section (3A) in section 212 of the Act of 1961, an assessee may be liable for interest in such cases as well. For instance, if the assessee's current total income is likely to exceed the amount on which tax is demanded by the Income Tax Officer by more than 33⅓ per cent, he should file an estimate of Current Total income, calculating the advance tax payable by him on that basis and pay tax accordingly. Failure to do so will make the assessee liable for interest as well as penalties under section 273 of the Act.[51]

---

49. The power relating to waiver of 'interest' was contained in the 'fifth' proviso of section 18A (6) of the Act of 1922 read with Rule 48. The proviso was added by s.13 of the Income Tax (Amendment) Act (15 of 1953). See I.T.O. Madurai v. M.R. Vidyasagar A.I.R. 1963 S.C. 503,504; Chockalingam and Meyyappan v. C.I.T., Madras, A.I.R. 1963 S.C. 1456. It was held that the proviso five to Sub-section (6) of Section 18A *mutatis mutandis* affects sub-section (8) as well. There may be as good a justification for not paying the advance tax wholly, as for not paying it partly. The decision overruled Lata Mangeshkar v. Union of India (1959) 36 I.T.R. 527 and T. Panchayarnathammal, Sivakasi v. C.I.T., Madras (1963) 1, M.L.J 109. In the latter cases the Courts took the view that the discretion to reduce or waive the interest conferred by the 'proviso' five to sub-section (6) of section 18A did not apply to sub-section (18), if no payment in advance at all was made.

50. Section 212(3A) has been added by the Finance Act (14 of 1969), section 16, with effect from April, 1969.

51. See *infra* pp.317-24 for text and cases on section 273.

The provisions relating to estimate of income tax are mandatory. In <u>Gursabhai Saigal</u> v. <u>C.I.T., Punjab</u>[52], the Supreme Court held that an assessee, who did not submit an estimate of income and pay advance tax as required under sub-section (3) of section 18A[53] of the repealed Act of 1922 would be liable to pay 'interest' under section 18A(8) of the Act. Sub-section (8) provided that:

> "Where, on making the regular assessment, the Income Tax Officer finds that no payment of tax has been made,... interest calculated in the manner laid down in sub-section (6) shall be added to the tax..."

The Court rejected the appellant's contention that since he had not paid tax at all, it was not possible to calculate interest in the manner laid down in sub-section (6) of section 18A of the Act. The relevant portion of the sub-section reads as follows:

---

52. A.I.R. 1963 S.C. 1062; <u>A.K. Bashu Sahib</u> v. <u>I.T.O</u> (1967) 66 I.T.R. 20. The fact that the delay in sending the estimate was only a day or two will not excuse a man of his liability and he will be treated in default. <u>C.I.T.</u> v. <u>Teja Singh</u>, A.I.R. 1959 S.C. 352. Failure to send an estimate of advance tax payable under section 18A (3) will make assessee liable for penalty under section 28 (i) (c) of the Act of 1922. See <u>infra</u> p. 324.
53. Income Tax Act, 1922, section 18A(3) provided for the submission of an estimate of tax, where the assessee was not previously assessed.

"Where in any year an assessee has paid tax... on the basis of his own estimate, and the tax so paid is less than eighty per cent of the tax determined on the basis of the regular assessment..., simple interest at the rate of six per cent per annum from the 1st day of January in the financial year in which the tax was paid up to the date of the said regular assessment shall be payable by the assessee upon the amount by which the tax so paid falls short of the said eighty per cent."

Their Lordships made a distinction in interpretation between a taxing provision creating a charge and a provision dealing with assessment machinery and said that:

"The proper way to deal with such a provision is to give it an interpretation which, to use the words of the Privy Council in Mahaliram Ramjidas's case, A.I.R. 1940 P.C. 124," makes the machinery workable, ut res valeat potius quam pereat."[54]

It may be noted that the Courts have made a distinction between 'interest' and 'penalty'.

The Bombay High Court in C.I.T., Bombay v. Jagdishprasad Ramnath,[55] while holding that the respondent had no right of appeal under section 30(1) of the Act of 1922, against the Income Tax Officer's order imposing 'interest' under section 18A(8) for the non-payment of 'advance' tax for the assessment years, 1947-48 and 1948-49, observed that:

---

54. A.I.R. 1963 S.C. 1062, 1065 (para 13). See India United Mills Ltd. v. C.E.P.T., Bombay A.I.R. 1955 S.C. 79,82; Whitney v. Commissioner of Inland Revenue (1926) 10 T.C. 88, 110; Allen v. Trehearne, (1938) 22 Tax Cas. 15,26.
55. A.I.R. 1955 Bom. 255; M/s Bhor Industries Ltd. v. C.I.T., Bombay City A.I.R. 1961 S.C. 1100.
Income Tax Act, 1922, section 30(1) provided that: "Any assessee objecting to the amount of income assessed... may appeal to the Appellate Assistant Commissioner against the assessment or against such refusal or order" Similar provisions are contained in section 246 of the Income Tax Act, 1961.

> "...[T] he legislature has clearly kept in mind the distinction between a penalty imposed under certain provisions of the Act and the interest which the assessee is liable to pay under S. 18A, and while providing for a right of appeal against orders of penalty, the legislature has not provided for any appeal against the payment of penal interest... T he scheme of the Act is that penal interest must follow upon the regular assessment; the appeal should be against the regular assessment, and in the regular assessment it should be open to the assessee to take all points which may legitimately not only reduce the taxable income or the tax to be paid... but also reduce the quantum of penal interest...[56]

Similarly, the Mysore High Court in Narayanappa and Brothers v. I.T.O.[57] held that an Income Tax Officer is empowered to impose a penalty and also to recover interest in respect of one and the same default under section 18A (8)[58] and section 46(1)[59] of the Act of 1922. The provision did not amount to an infraction of the right to equal protection of laws, embodied in Article 14 of the Constitution as contended by the assessee, the reason being that the objects of interest and penalty are altogether different. The

---

56. A.I.R. 1955 Bom. 255,258 (para 6).
57. A.I.R. 1960 Mysore 40, at p. 43 (para 25)
58. Income Tax Act, 1922, section 18A (8) provided that the Income Tax Officer shall add 'interest' in case of failure to pay advance tax according to the provisions of the Act on regular assessment. Income Tax Act, 1961, section 217 contains the similar provisions.
59. Income Tax Act, 1922, section 46(1) laid down the provision relating to imposition of penalty in case of failure to pay tax on demand under section 29. Income Tax Act, 1961, section 221 contains similar provision.

interest is payable to the Government by reason of the assessee having withheld from the Government advance tax he was bound to pay, while penalty is in the nature of a punishment.

Chagla, C.J., delivering the judgement of the Bombay High Court in Aruna Mills Ltd. v. C.I.T., Bombay, said:

> "... [F]ailure to pay advance tax is not a penalty in the sense of the default carrying with it any mens res or subjecting the defaulter to any severe punishment."[60]

And Balkrishna Ayyar, J., speaking for the Madras High Court in Magappa Chettiar v. I.T.O., Padukottai, said that:

> "... [T]here is no element of penalty either in sub-sec. (6) or sub-sec. (8) (of section 18A of the Act of 1922). The interest charged under those sections is an impost in the same way as income-tax is an impost."[61]

However, the imposition of 'interest' is not automatic. The assessee must be given an opportunity of being heard before the levy of such interest. In Chockalingam and Mayyappan v. C.I.T., Madras[62], the Supreme Court held that the denial of a hearing would amount to a violation of natural justice, even if interest is levied

---

60. A.I.R. 1956 Bom. 756 at p. 758. (para 4)
61. A.I.R. 1959 Mad. 205, at p. 208 (para 13), V.N.S. Sockalingam Chettiar v. I.T.O. A.I.R. 1959 Mad 509. It was held that interest was not a penal interest.
62. A.I.R. 1963 S.C. 1456.

under section 35 of the Act of 1922[63], analogous to section 154 of the Act of 1961, in pursuance of rectification of a mistake in assessment.

An assessee is not entitled to take advantage of his own wrongs. Accordingly, interest paid by the assessee on account of failure to pay advance tax is not allowed as a deduction[64]. And interest received from the Government[65] on excess advance tax paid is taxable, being income by way of interest similar to profits earned out of an investment[66].

Penalties, in Chapter 21 of the Act of 1961

The provisions relating to the imposition of administrative penalties are later additions to the Income tax statutes in India than those relating to criminal penalties. Whereas provision for criminal penalties was made as long ago as 1869[67], the administrative penalties were added on the statute book only in 1918[68]. And it was only

---

63. Income Tax Act, 1922, section 35 authorized the Income Tax authorities to rectify any mistake apparent on record, either on their own motion or when such a mistake was brought to their notice by a party to the proceedings Sidhramappa Andannappa v. C.I.T. (1952) 21 I.T.R. 333.
64. Balmer Lawrie and Company v. C.I.T. (1960)39, I.T.R. 851.
65. Income Tax Act, 1961, sections 214,243 and 244 provide for interest payable by the Government.
66. C.I.T. v. Maharajadhiraj Sir Kameshwar Singh (1953) 23 I.T.R. 212; Visheshwara Singh v. C.I.T. (1954) 26 I.T.R. 573, 588.
67. Supra note 3.
68. The Income Tax Act, 1918, section 24, provided an administartive penalty for concealment of income. It was only with regard to payment of tax on demand that the Income Tax Act, 1886, had provided a penalty for default under section 30(1) of the Act.

in 1961, by the enactment of Act 43 of 1961, that for the first time the penal provisions, previously scattered all over the texts of the Income Tax Acts, were collected in a separate chapter 21, entitled: 'Penalties Imposable'. No doubt,some of the penal provisions are still scattered about the Act, but they are limited in number and are less important as compared with those incorporated in Chapter 21.

Chapter 21 is a small chapter, consisting of six sections only, namely, sections 270 to 275. The first four sections, (270 to 273) provide the substantive penalties for defaults committed under the Act, and sections 274 and 275 lay down the procedure to be adopted and the periods of limitation in the imposition of the penalties.

Administrative penalties under the Indian Income Tax statutes, like the penalties provided under the Income Tax Acts of other countries, viz., the United Kingdom[69], the United States of America[70], Australia [71],

---

69. Taxes Management Act (1970 c.9), Part 10 provides provision for imposition of penalties in sections 93 to 107. See sections 95,96 for ad valorem penalties. The Act also provides for 'exigible penalties' in certain cases. See British Tax Encyclopedia , Wheatcroft, G.S.A. (1970), Vol.I. paras 1-1409, p. 1692/1.
70. Inland Revenue Code, 1954, chapter 68, sections 6651 to 6680, provides provisions relating to civil penalties. See., 'Tax Fraud and Evasion' Harry Graham Balter. (1963), 3rd ed., para 8.5; Fraud and Federal Means Tax in the United States,Harold M. Groves and Arthur M. Selle (1953) 7, Bulletin for International Fiscal Documentation 321 at p. 322. Administrative Penalties are called civil penalties and assessed and collected as a part of the tax. The civil penalties are of two types viz., fraud and non fraud.
71. Income tax and Social Services Contribution Assessment Act, 1936-69, Part 7. See Sections 226,227,230,231.

Canada[72] and New Zealand are _ad valorem_ penalties imposed as a percentage of the tax liability. Administrative penalties have assumed great significance in the programme of tax crime control in recent years and are being frequently invoked by the Income Tax authorities than criminal penalties. The penalties provided under the Act may be broadly classified into those provided in Chapter 21 and those outside it. There are five main types of penalties in Chapter 21 and three outside of it[74]. Penalties prescribed within Chapter 21 are:

(i) for concealment of income,

(ii) for failure to furnish return or comply with notices,

(iii) for failure to furnish information regarding securities and dividends,

(iv) for failure to give notice of discontinuance of business, profession or vocation and

(v) for making false estimate of tax and failure to pay tax in advance.

---

72. Income Tax Act, 1952, 5.55 (1) (delay in making return); S. 55(3) (failure to supply information) and S.56(1) (penalty for tax evasion). See '_Canadian Income Tax: A Treatise of Income Tax Law of Canada_', Toronto, 1970, pp. 1500, 2854-2856.

73. The Land and Income Tax Act, 1954, Sections 228 to 238, deal with penalties. Section 231 provides for penal tax in case of tax evasion to the extent of treble the deficiency.

74. See _infra_ pp. 331-39 for penalties outside Chapter 21. _R. Presad Mohanlal_ v. _I.T.A. Tribunal_ A.I.R. 1970 All 620,627 (para 23) (P.B.). S. Bhoothalingham in his '_Final Report on Rationalisation and Simplification of the Tax Structure_'(1968), Government of India, at p. 78, has classified penalties into four heads:-
(i) For giving low estimates of income in connection with advance payments,
(ii) failure to file a return of income within the time allowed,
(iii) failure to produce books of account, etc., when called upon to do so, and
(iv) concealment of income or giving inaccurate particulars of income.

The Income Tax Act, 1961, in clause (c) of sub-section (1) of section 271, has providéd one of the most important penal provisions to combat tax evasion and the Income Tax authorities have applied this provision far more frequently than any other penal provision. As a result it has been the subject of the largest number of cases and is a subject of much controversy.

The origin of this principal administrative sanction is to be found in section 24 of the Income Tax Act (7 of 1918), which for the first time, bestowed on the Collector[75] and Commissioner[76] power to assess and collect income tax and to invoke penal provisions against an assessee in case of concealment of income. Section 24 provided as follows:-

> "if the Collector or the Commissioner, in making any assessment or adjustment,... is satisfied that the assessee has concealed the particulars of his income, or has deliberately furnished inaccurate particulars of such income, and has thereby returned it below its real amount, the Collector or the Commissioner may direct that the assessee shall pay on the difference between his income, as finally ascertained, and the amount originally returned by him, income tax at a rate not exceeding double the rate which would otherwise have been payable: provided that no such order shall be made, unless the assessee has been heard, or has been given a reasonable opportunity of being heard;
> Provided further that no prosecution for an offence against this Act shall be instituted in respect of the same facts on which a penal assessment is made under this section."

---

75. Income Tax Act, 1918, section 2(5).
76. Income Tax Act, 1918, section 2(6).

The following conditions had to be fulfilled before section 24 could be invoked:-

(1) The revenue authorities had to be satisfied, when making any assessment or adjustment under Chapter II dealing with 'Deductions and Assessments', that the assessee

(a) had concealed particulars of his income, or

(b) had deliberately furnished inaccurate particulars of such income, and thereby returned it below its real income.

(2) The assessee had to be given a reasonable opportunity of being heard[77] before assessment could be levied. A proviso to the sub-section imposed a bar on prosecution for an offence in respect of the same facts on which the penal assessment had been made.[78]

The Income Tax Act, 1922, repealed the Income Tax Act, 1918, but retained the provisions of section 24 with a slight modification of section 28 of the Act. The original section 28, which provided a 'penalty for concealment of income or improper distribution of profits' runs as follows:-

> "Section 28(1). If the Income Tax Officer, the Assistant Commissioner or the Commissioner in the course of any proceedings under this Act, is satisfied that an assessee has concealed the particulars of his

---

77. See *infra* pp. 293-99 for discussion on 'reasonable opportunity'.
78. The Income Tax Act, 1961, has no such provision. A person now may be liable both for penalty and prosecution.

income, or has deliberately furnished inaccurate particulars of such income, and has thereby returned it below its real amount, he may direct that the assessee shall in addition to the income tax payable by him, pay by way of penalty a sum not exceeding the amount of income tax which would have been avoided, if the income so returned by the assessee had been accepted as the correct income."

On a perusal of section 28 of the Income Tax Act, 1922, and section 24 of the Income Tax Act, 1918, the following differences become evident:

(i) Section 28 of the Act of 1922, has used the word 'penalty'[79], whereas 'penal assessment' was used in section 24 of the Act of 1918.

(ii) Section 28 of the Act of 1922, has substituted 'Income Tax Officer' and 'Assistant Commissioner' in place of 'Collector' used in section 24 of the Act of 1918.

(iii) Section 28 of the Act of 1922, appears to be wider in scope than section 24 of the Act of 1918, inasmuch as, under the former, a penalty could be levied 'in the course of any proceeding', whereas 'penal assessment' under the latter could be levied 'in the case of assessment or adjustment' only. The former would include cases of

---

79. The Report of the All India Income Tax Committee, 1921, in para 40, made a recommendation for the amendment of section 24 of the Income Tax Act, 1918, so as to make it clear that the penalty imposed under it is a 'penalty' and not 'income tax'.
The Law of Income Tax in India, V.S. Sundaram, Vol.I, 4th ed 1936, p. clxxiii.

revisional proceedings[80] and cases of refund[81], while the latter would not[82].

The year 1939 inaugurated a new era in the administration of the law of Income Tax in India[83]. A number of changes of significance were made in the Act of 1922 to deal with cases of an unusually difficult nature or cases in which concealment of income on a large scale had taken place.

The relevant portion of the sub-section (1) of section 28 ran as follows, after the amendment:

> "28(1) If the Income Tax Officer, the Appellate Assistant Commissioner or the Appellate Tribunal, in the course of any proceedings under the Act, is satisfied that any person-
> ....
> (c) has concealed the particulars of his income or deliberately furnished inaccurate particulars of such income,
> he or it may direct that such person shall pay by way of penalty, ... in addition to any tax payable by him, a sum not exceeding one and a half times the amount of the income tax and super tax, if any, which would have been avoided if the income as returned by such person had been accepted as the correct income.

The Act of 1939 brought about the following changes in sub-section (1) of section 28 of the Act of 1922:-

---

80. Income Tax Act, 1922, section 33A.
81. Income Tax Act, 1922, sections 48 and 49.
82. '<u>The Law of Income Tax in India</u>', V.S. Sundaram, 6th ed., 1954, p. 908.
83. (1939) 7, Income Tax Report, p.1. (Journal Section).

(i) The scope of sub-section (1) of section 28 was enlarged, i.e., penalties for two new types of defaults were added[84], and a penalty for concealment of income was provided in sub-clause (c) of sub-section (1) of section 28.

(ii) The maximum amount of penalty for concealment of income was increased from 'the amount of tax which would have been avoided' to 'one and a half times the amount of tax which would have been avoided', in order to make the penalty more stringent.

(iii) The word 'super-tax' was inserted along with 'income-tax', to make it clear that the penalty for concealment of income applied to cases of'super-tax' as well.

(iv) The power to impose the penalty was taken away from the 'Commissioner' and given to the 'Appellate Tribunal'.

Section 271 of the Income Tax Act, 1961, corresponds to section 28 of the Income Tax Act, 1922, with certain modifications. The relevant portion of sub-section (1), which deals with the penalty for concealment of income stood originally as follows:

> "Section 271(1)(c). If the Income Tax Officer or the Appellate Assistant Commissioner, in the course of any proceedings under this Act, is satisfied that any person-
> ....
> (c) has concealed the particulars of his income or

---

84. See <u>infra</u> pp. 317 - 24 for two types of defaults.

deliberately furnished inaccurate particulars of such income,
he may direct that such person shall pay by way of penalty,-
(iii) ..., in addition to any tax payable by him, a sum which shall not be less than twenty per cent but which shall not exceed one and a half times the amount of the tax, if any, which would have been avoided, if the income, as returned by such person, had been accepted as the correct income."

The distinguishing features of sub-section (1) of section 271 are as follows[85]:

The jurisdiction to impose a penalty has been conferred on Income Tax Officers and Appellate Assistant Commissioners only, whereas section 28 of the Act of 1922, authorised the 'Appellate Tribunal' as well.

An Income Tax Officer does not need the previous sanction of the Inspecting Assistant Commissioner before imposing the penalty, as was required by the corresponding provisions in the Act of 1922[86]. However, where the maximum penalty imposable exceeds Rs. 1,000, the Inspecting Assistant Commissioner[87] alone is empowered to impose it, whereas, under section 28 of the Act of 1922, the Income Tax Officer had such power once the approval of the Inspecting Assistant Commissioner had been obtained[88].

85. See supra note 30, at p. 1033; R. Prasad Mohan Lal v. I.T.A. Tribunal A.I.R. 1970, All 620,629 (para 27) (F.B.) Messrs. Jain Brothers v. Union of India A.I.R. 1970 S.C. 778 at p. 783.
86. Gnanmbika Mills Ltd. v. C.I.T. Madras? I.L.R.(1966) 2 Mad. 491,494; In re Kishore Chand Ramji Das A.I.R.1950 E.P. 814.
87. Income Tax Act, 1961, section 274 (2).
88. Income Tax Act, 1922, section 28(6). In Lachman Dass Mehar Chand v. Income Tax Appellate Tribunal Delhi (1944) I.T.R. 432 (Lahore), it was held that the sub-section (6) of section 28 does not contemplate a hearing being given to an assessee by the Inspecting Asst. Commissioner before approving the penalty to be imposed by the Income Tax Officer.

Sub-clause (iii) of sub-section (1) of section 271 provides a minimum penalty imposable in cases of concealment of income or furnishing of inaccurate particulars of income as provided under clause (c). There was no provision for a minimum penalty in the corresponding provisions of the previous Acts. However, the Commissioner of Income Tax may reduce or waive the minimum penalty in appropriate cases under sub-section 4A of section 271 of the Act[89].

Penalty proceedings must be initiated by the Income Tax Officer or the Appellate Assistant Commissioner in the course of assessment proceedings and should be completed within two years of their commencement, according to section 275 of the Act. There was no such provision in the Income Tax Act of 1922[90].

The bar to the launching of prosecutions in respect of the same facts on which a penalty has been imposed, has been done away with[91].

---

89. See Chapter 5, p. 211, f.n. 42.
90. R. Prasad Mohanlal v. I.T.A. Tribunal, A.I.R. 1970 All 620, 638 (F.B.)
M/S Ramkrishna Baldeo Prasad v. C.I.T., U.P. A.I.R. 1968 All 53; C.I.T., Bihar and Orissa v. Rupsa Rice Mills, 1964 54 I.T.R. 328 (Orissa).
91. Income Tax Act, 1922, section 28(4) had given an immunity from prosecution for a default in respect of which a penalty was imposed upon the assessee.

In 1964 two important changes were made in sub-section (1) of section 271, by section 40 of the Finance Act, 1964. The changes are of great significance, as they relate to the assessee's liability in case of penal proceedings. The changes are as mentioned:

Firstly, the word 'deliberately', occurring before the words 'furnished inaccurate particulars of such income' in clause (c) of sub-section (1) of section 271, was obliterated with effect from April 1, 1964. Clause (c) after the amendment, runs as follows:

> "271(1) If the Income Tax Officer or the Appellate Assistant Commissioner in the course of any proceedings under this Act, is satisfied that any person-
> ...
> (c) has concealed the particulars of his income or (   ) furnished inaccurate particulars of such income,..."

Secondly, an Explanation clause'[92] was added to sub-section (1) of section 271. The clause provides that, if the total income returned by an assessee is less than eighty per cent of the total income assessed, the assessee shall be liable for concealment of income under clause (c) of sub-section (1) of section 271. In other words, the assessee will be deemed to have concealed the particulars of his income, or furnished inaccurate particulars of his income, unless he proves that the failure to return the correct income did

---

92. See <u>infra</u> p.313 for text of explanation clause.

not arise from any fraud, or any gross or wilful neglect on his part.

Section 19 of the Finance Act, 1968, seeks to amend sub-clause (iii) of sub-section 271 of the Act of 1961, in order to increase the quantum of penalty prescribed for concealment of income under clause (c) of sub-section (1) of section 271.

Sub-clause (iii) provides that,

> "In the case referred to in clause (c), in addition to any tax payable by him, a sum which shall be not less than, but which shall not exceed twice the amount of the income in respect of which the particulars have been concealed or inaccurate particulars have been furnished."

The amendment makes the penalty for concealment of income more stringent and concealment unprofitable to ingeneous taxpayers, if the provisions are implemented promptly. The amendment shifts the basis for concealment of penalty from the amount of 'tax avoided', as was the earlier practice, to the amount of the 'concealed income'. In other words, it makes the concealment of income the yard-stick for measurement of the penalty and not the amount of tax sought to be avoided as previously because the original provision did not wotk well[93].

---

93. '<u>Penalty Provisions Under the Income Tax Act and Wealth Tax Act - Legal Aspects of Implications - and Justification of Recent Changes</u>', R.S. Gae. Report on 3rd All India Conference of Tax Executives (1968), 103 at pp. 107-108 (para 98).

In brief, clause (c) of sub-section (1) of section 271 deals with making false returns[94]. The clause requires two conditions to be fulfilled for a penalty to be imposed. Firstly, the Income Tax Officer or the Appellate Assistant Commissioner must be satisfied 'in the course of any proceedings'[95], and secondly, that the assessee must have either concealed the particulars of his income, or 'furnished inaccurate particulars of such income'.

The penal provisions contained in section 271 (1)(c) of the Act appear to be very simple but they are not so in fact. They have aroused much controversy amongst the scholars and lawyers. Courts are also not unanimous in their interpretation.

Procedure for Levy of Penalty.

The proceedings for the levy of penalty must be initiated by a prescribed authority[96] in the course of proceedings under the Act[97], and that such authority must be satisfied about the existence of conditions specified in clauses (a), (b) and (c) of sub-section (1) of section 271 before starting proceedings[98]. And a person against

94. C.I.T. Delhi v. Teja Singh A.I.R. 1959 S.C. 352,354.
95. C.I.T., M.P. v. Punjabhai Shah A.I.R. 1968 M.P.103, 106.
96. Messrs. Mayaram Durga Prasad v. C.I.T., U.P. 5, I.T.C.
97. R. Prasad Mohan Lal v. I.T.A. Tribunal A.I.R. 1970 All. 620,632 (para 35) (F.B.).
98. C.I.T., Madras v. S.V. Angdi Chettiar A.I.R. 1962 S.C. 970; Gopichand Sarju Prasad v. Union of India A.I.R. 1969 M.P. 220,225; C.I.T., Assam v. Tezapur Automobiles A.I.R. 1969 Assam 122,123.

whom proceedings are to be taken should be given a reasonable opportunity of being heard before any order imposing a penalty is passed[99]. Compliance is essential in order to make the order imposing a penalty valid[1]. The provision is

---

99. Income Tax Act, 1961, section 274 (1) (Corresponding to Income Tax Act, 1922, section 28 (3)). See Banarsi Das v. C.I.T., Punjab, A.I.R. 1936 Lah. 585, 586; Gnanmbika Mills Ltd. v. C.I.T., Madras I.L.R. (1966) 2 Mad. 491 494; Bhajuram Ganpatram v. C.I.T., Bihar and Orissa, A.I.R. 1970 Orissa 38,40; Naddula Appa Rao v. I.T.O. A.I.R. 1959 A.P.391. Messrs. Jain Brothers v. Union of India, A.I.R. 1970 S.C. 778,783

1. Ayyasami Nadar and Brothers v. C.I.T., Madras A.I.R. 1957 Mad. 74. Grant of a reasonable opportunity is sufficient compliance with the requirements of section. If the opportunity is not availed of, a notice does not become invalid on that account. Contra. see Shrilal v. C.I.T., Bihar and Orissa A.I.R. 1956 Orissa 33. It was held that the Income Tax Officer must hear the assessee before imposition of penalty under section 28 of the impugned Act, 1922. It was further held that in case that the assessee does not appear before the Income Tax Officer and renders no explanation the Income Tax Officer could not levy a penalty because it would amount to a denial of 'reasonable opportunity' as contemplated by sub-section (3) of section 28. It is submitted with respect that Orissa High Court's view needs revision. The view is too narrow and defeats the very purpose of the provision. In Messrs Murlidhar Tejpal v. C.I.T., Patna, I.L.R. (1961) 40 Pat 571, it was held that the succeeding Income Tax Officer had power to initiate proceedings from where his predecessor left off. He need not call for a fresh explanation from the assessee, when his predecessor had already complied with the requirement for imposing a penalty under section 28 (1)(c) of the Act of 1922. The Act of 1961 has provided similar provisions as those contained in the Act of 1922, in this connection.

based on the Roman maxim of audi alteram partem[2], hear the the other side. The question whether a person was given a reasonable opportunity of being heard in a particular case is a question of fact[3].

The scope of the phrase 'in the course of any proceedings' appears to be wide[4]. For instance, a penalty may be imposed in the course of any proceedings under the Act, e.g., in assessment[5], additional assessment[6], and appeal[7].

However, the assessment or reassessment must relate to the same assessee and the same period for which his default is called in question.[8] The Supreme Court in Messrs Guduthur Brothers v. I.T.O., Special Circle, Bangalore[9], held that the Income Tax Officer had jurisdiction to start penalty proceedings again, if the earlier order imposing penalty for failure to furnish return within the time was

---

2. Anantha Naganna Chetty v. C.I.T., A.P. Hyderabad, A.I.R. 1970 A.P. 367.
3. Butto Kristo Kamala Kanta Saha v. C.I.T., Bihar and Orissa 5 I.T.C. 122 (Patna)
4. C.V. Goundarajulu Iyer v. C.I.T., Madras A.I.R. 1949 Mad. 399 at p.401.
5. 'The Civil Court Manual (Central Acts)' A.I.R. Publication, 10th ed., Vol.V. (1961), p. 6010.
6. In re Gurcharan Prasad A.I.R. 1931 All 421
7. Malik Damsaz Khan v. C.I.T., Punjab A.I.R. 1947 P.C. 176 Kamlapat Motilal v. C.I.T. (1962)45 I.T.R. 266 (S.C.)
8. C.I.T. Hyderabad v. Angoru Satyum A.I.R. 1960 A.P. 205.
9. A.I.R. 1960 S.C.1326.

set aside, due to the failure to give a hearing to the assessee, after correcting the error. The appellant failed to file a return of income for the year 1948-49 within the prescribed time. The Income Tax Officer issued a notice to the appellant to show cause why a penalty should not be imposed[10]. The appellant filed a written reply. The Income Tax Officer imposed a penalty of Rs. 16,000/- without affording a hearing, as required by sub-section (3) of section 28 of the Act of 1922. The order was set aside by the Appellante Assistant Commissioner who pointed out the defect. Thereafter, the Income Tax Officer started fresh proceedings, giving an opportunity to the assessee of being heard, as required.

Their Lordships rightly held that the Penalty proceedings which were started again could be described as the continuance of the original assessment proceedings, because the action would relate back to the time when the notice was issued.

An important question that arises in this connection is whether a penalty may be inflicted for concealment of

---

10. Income Tax Act, 1922, section 28(1)(a) provided for levy of penalty in such cases. The corresponding provision in the Act of 1961 is section 271(1)(a). Navayuga Traders v. C.I.T. A.P., A.I.R. 1971 A.P. 31, It was held that the Income Tax Officer could rectify a mistake and send a notice under section 274 of the New Act. The fact that the first notice issued under the old Act does not make the second proceeding illegal.

income or furnishing inaccurate particulars of income, if the Income Tax authorities come to know of the fact of concealment, after the close of the assessment proceedings. Courts are divided on the point.

The Allahabad High Court held in Messrs. Mayaram Durga Prasad v. C.I.T. U.P.[11], that the appellant would not be liable for a penalty for concealment of income under section 28 (1) of the Act of 1922, for defaults made in his return of income at the time of the original assessment, discovered in the course of assessment proceedings under section 34 of the Act of income escaping assessment.

The appellant, an unregistered firm, was assessed at Rs. 2,650 for 1929-30. Afterwards it was discovered that the assessee had a much higher income, so he was assessed under section 34. This time he made a return of Rs.38,327. The Income Tax Officer, being of the opinion that the previous return of Rs. 2,650 was minimized deliberately, in order to avoid payment of the just and proper tax, inflicted a penalty under section 28 (1)[12]. While allowing the appeal, their Lordships, said that:

> "...[T]he proceedings which terminated with the assessment of the income at the figure of Rs.2,650 are proceedings distinct from the proceedings under section 34 of the Income Tax Act. That being so, it

---

11. (1930) 5 I.T.C. 471; Seth Kashinath Bagle v. C.I.T., U.P., 4 I.T.C. 472.
12. See supra p283/4 for text of section 28(1).

> cannot be said that the assessee "has concealed the particulars of such income". If the two proceedings are separate, a reference to the previous proceedings can be made only by the use of the verb "to have" in the past tense,, and not by the use of the verb in the present tense. The result is: None of the ingredients necessary to bring the case within the purview of ss (1) of s. 28 exist in this case, and the levy of penalty was wrong in law."[13]

Similarly, the Allahabad High Court in re Gurcharan Prasad Khatri,[14] held that where the income was returned wrongly, both during the original assessment under section 23 and also during the assessment for escaped income under section 34, a penalty could be imposed in respect of the latter concealment only and not the former. It was contended that the original proceedings, which terminated in the assessment, were closed and were no longer before the Income Tax Officer and the proceedings under section 34 were fresh proceedings in respect of escaped income; no action could be taken in respect of proceedings already closed.

On the other hand, the Madras High Court in C.I.T., Madras v. Sheikh Abdul Kadir Maracayar,[15] held that, even if the Commissioner finds in the course of revision that there had been concealment of income in the original proceedings, he can levy a penalty.

In another case, C.V. Govindarajulu Iyer v. C.I.T., Madras[16], it was held that there was nothing in the language

13. (1936) 5, I.T.C. 471 at p. 474.
14. (1931) A.L.J. 336.
15. 2 I.T.C. 372.
16. A.I.R. 1949 Mad. 399.

of section 28, which prevents an Income Tax Officer, if he is satisfied, in the course of a proceeding under section 34 relating to a particular period of assessment, that default has occurred at the earlier stage, from levying a penalty.

The appellant, in spite of a general notice under section 22(1) of the Act of 1922, did not, within the prescribed period, submit his return for the assessment years ending 12th April, 1942 and 13th April, 1943. The Deaprtment, however, did not proceed to issue notice under section 22(2) of the Act within the respective years of the assessment. Subsequently, on 25th January 1945, the Income Tax Officer issued notices under section 34 and section 28 imposing a penalty for failure of the appellant to file his returns, in pursuance of the general notice issued under section 22(1) of the Act. A penalty was imposed, which was confirmed in an appeal by the Appellate Assistant Commissioner and the Tribunal.

The appellant, relying on the decisions of the Allahabad High Court in Mayaram Durga Prasad[17] and re Batuk Prasad[18], contended that it was not competent for the Income Tax Officer to levy a penalty in the course of a proceeding under section 34 of the Act for a default not

17. (1930) 5, I.T.C. 471.
18. (1931) A.L.J. 336.

committed in those proceedings. Rejecting the above contention, their Lordships said that:

> ".. [S] o long as the proceedings under s. 34 relate to the assessment for the said period as the original assessment, the Income Tax Officer will be competent to levy a penalty on any ground open to him under section 28(1), even though it relates to the prior proceeding... We do not find any justification for the artificial separation of a proceeding under S.34 from a proceeding relating to the original assessment or to proceedings which started before a notice under S. 34, so long as they all relate to the same assessee and the same period"[19].

It is submitted, with respect, that the Allahabad view is too narrow and needs reconsideration in the light of the Madras decision. It is a well established fact that a revised return of correct income made, after the Income Tax Officer has come to know of the fact of concealment, will not excuse a previous wrong return, made dishonestly and deliberately and absolve an assessee from penal liability[20]. On the same parity of reasoning the Andhra Pradesh High Court held in C.I.T., Hyderabad v. Angaru Satyam[21], that when it is discovered, in proceedings under section 34 of the Act of 1922, that the assessee had made a concealment of income in respect of the original assessment under section 23, it could not be condoned, merely because the subsequent return

---

19. A.I.R. 1949 Mad. 399, pp. 400,401 (para 3).
20. See Report of the Income Tax Investigation Commission, 1949,(Government of India), p. 100;'Income Tax Act, 1922', A.N. Aiyar,(7th ed., 1950) p. 584; Vadilal Ichhachand v. C.I.T., (1957) 32 I.T.R. 569. Dayabhai Girdharbhar v. C.I.T., M.P. A.I.R. 1958 Bom. 426.
21. A.I.R. 1960 A.P. 205.

was correct and accepted by the authorities. To hold otherwise would amount to putting a premium on dishonesty.

Another important question that arises in this connection is whether the notice of the contemplated penalty proceedings under section 271(1) of the Act of 1961, should be given before the assessment order is passed or whether it can be given later.

The question came before the Calcutta High Court for decision in Guru Prosad Shaw v. C.I.T., Bengal[22]. The Income Tax Officer passed an assessment order upon the assessee on 23rd January 1941. At the same time he discovered that the assessee had not made a return of income and had deliberately failed to disclose it. Accordingly, a notice was served upon the assessee on 25th January to show cause why a penalty should not be inflicted, as provided in section 28 and on 2nd May 1941, a penalty was imposed.

The assessee contended that notice should have been given before the close of the assessment proceedings, but the Court said:

> "There is nothing in S.28 from which it can be said that the notice under sub-s (3) must be given before

---

22. A.I.R. 1945 Cal. 65.

the conclusion of the assessment"[23]

The Supreme Court has also said in C.I.T., Madras v. S.V. Angidi Chettiar[24] that the proceedings to levy a penalty need not be commenced before the completion of the assessment proceedings.

Concealment of Income

The word 'conceal' originated in the French word 'conceler' and the Latin term 'concēlāre, which means, to hide with intent (con., = intent and celārē = to hide). In standard English dictionaries, the term has been defined as 'to hide', 'to keep secret', 'to disguise', 'to keep from telling' and so on[25].

We are concerned with the question what amounts to 'concealment' for the purposes of imposing a penalty under section 271(1)(c) of the Act. Should omission or failure to

---

23. A.I.R. 1945 Cal. 65,66. See Banarsi Das v. C.I.T., Punjab A.I.R. 1936 Lah. 585. C.I.T., Madras v. Abdul Kadir A.I.R. 1928 Mad. 257. The Madras High Court in Sivagamintha Moopanar and Sons v. C.I.T., Madras, A.I.R. 1956 Mad. 1, and the Lahore High Court in Vir Bhan Bansi Lal v. C.I.T., Punjab (1938) I.T.R. 616, have taken a contrary view. According to the Madras and Lahore High Courts the notice asking the assessee to show cause why a penalty should not be levied for concealment of income, must be issued before the assessment order is made.
24. A.I.R. 1962 S.C. 970,974. The position under the Act of 1961 is similar. Shakti Offset Works v. Inspecting Assistant Commissioner (1967) 64 I.T.R. 637 (Bom.) See supra note 30, pp. 1042, 1043 for contrary view.
25. 'Chambers Twentieth Century Dictionary', (1968), p. 217.

disclose a fact, in order to be termed 'concealment' be intentional and deliberate, or is a bare omission or failure to account for the material facts required sufficient to bring a man within the clutches of the law?

The majority of the High Courts have held that the act of concealment in order to attract a penalty under section 271(1)(c) of the Act of 1961, must be a 'deliberate' concealment. For instance, Venkatadri, J., delivering the judgement of the Madras High Court in A.V. Thomas and Company Ltd. v. C.I.T., Madras said:

> "The word 'conceal' implies something more than mere failure to disclose ... To constitute concealment, it must appear that the statement or act of the person was calculated and designed to prevent discovery of the act with which he is charged ... All that it involves is the principle that the act must be attributable to the person, that is, it must have been done intentionally and not accidentally".[26]

Similarly Rajgopalan, J., in Radha Rukmani Ammal v. C.I.T., Madras, said:

> "The concealment penalized under S. 28 must be concealment of which the assessee is conscious. Further it must be a concealment from the assessing authority".[27]

The facts of the case are as follows. Subbarayulu Chettiar was the karta (manager) of a Hindu undivided family which

---

26. I.L.R. (1967) 1 Mad. 255, p. 263, 264; see T.P. Hariram Suit v. C.I.T., Madras A.I.R. 1955 Mad. 653.
27. A.I.R., 1957, Mad 568,569, Section 171(8) of the Act of 1961 imposes joint and several liability on the members of a Hindu undivided family in regard to the levy and collection of any penalty including interest or a fine.

consisted of his two minor sons and himself. S. Chettiar made some fictitious entries in the account books and also omitted to enter some receipts in it, but, before making his return for the assessment year 1944-45, on behalf of the Hindu undivided family, he died. After his death, Radha Rukmani Ammal, wife of S. Chettiar, represented the Hindu undivided family as the guardian of the minor coparceners and filed the return for the assessment year 1944-45.

The Income Tax Officer assessed the income of the Hindu undivided family on the basis of this return. But, he subsequently came to know of the concealment of income and fictitious entries[28]. Accordingly, the Income Tax Officer issued a notice under section 28(3) and imposed a penalty under section 28(1)(c) of Rs. 5,000, which was confirmed in appeal by the Appellate Assistant Commissioner and the Income Tax Tribunal.

The High Court arrived at a different conclusion and held that, as the deceased karta had not concealed any income from the Income Tax authorities, and the succeeding karta was neither conscious of any concealment nor had a guilty mind, a penalty could not be levied on the family

28. Messrs. Nagin Chand Shiv Sahai v. C.I.T., Punjab (1938) 6 I.T.R. 534 (Lahore). If a person claims a false deduction, he is liable to a penalty.

under section 28(1)(c) for concealment of income.

The Bombay High Court in C.I.T., Ahmedabad v. Gokuldas Harivallabhdas[29], said that penalty proceedings under section 28(1)(c) were in the nature of penal proceedings and the fact that the explanation adduced by the assessee in regard to particular income is false, does not make him liable for a penalty.

The assessee was carrying on business in partnership with his brother at Nadiad in Ahmedabad. On 25th October, 1946, the assessee opened a branch in Bombay. The Income Tax Officer, while examining the assessee's accounts, found a sum of Rs. 15,205 credited in the names of a few persons of the Bombay branch. Being dissatisfied with the assessee's explanation, the Income Tax Officer assessed the amount as income from undisclosed sources and imposed a penalty of Rs. 4,000 under section 28(1)(c).

While rejecting the Revenue's claim to be entitled to ,impose the penalty, the court said,

> "The gist of the offence under s. 28(1)(c) is that the assessee has concealed the particulars of his income or deliberately furnished inaccurate particulars of such income. Therefore, the Department must establish that the receipt of Rs. 15,203/- constitute 'income'of the assessee. There is not an iota of evidence on the record, except the explanation given by the assessee, which explanation has been found to be false. Now, it does not follow that because the particular explanation given by the assessee is false, therefore necessarily the receipt of Rs. 15,203/- constitutes taxable income of the assessee."[30]

29. A.I.R. 1959 Bom. 96; T.P.Hari Ram Sait v. C.I.T., Madras , A.I.R. 1955 Mad. 653.
30. Ibid p. 97 (para 3).

The Madhya Pradesh High Court in C.I.T., M.P. v. Punjabhai Shah[31], expressed agreement with the view of the Bombay High Court in Gokul Das Harivallabhdas. The Court said:

> "...[T]he bare fact that the explanation offered by the assessee in assessment proceedings was rejected and it was held in those proceedings that he had concealed his income or that the explanation was unsatisfactory by itself cannot be made the basis of the conclusion that he has been guilty of deliberately concealing the particulars of his income."[32]

The Gujarat High Court in C.I.T., Gujarat v. L.H. Vora,[33] has also approved of the Bombay view in the Gokuldas Harivallabhdas case.

The Patna High Court in the case of Messrs. Khemraj Chagganlal v. C.I.T., Bihar and Orissa[34], held that the mere fact that the assessee was not able to establish by satisfactory evidence the source of income did not imply that the explanation was false and that the assessee had been guilty of supression of facts within section 28(1)(c) of the Act of 1922. This view was affirmed by the Court in Murlidhar Tejpal v. C.I.T., Patna[35].

On the other hand, the Allahabad High Court in Hazi Abdul Rehman, Abdul Qayuum v. C.I.T., U.P.[36], observed

---

31. A.I.R. 1968 M.P. 103.
32. A.I.R. 1968 M.P. 103,106 (para 6).
33. (1965) 56 I.T.R. 126 (Guj.).
34. A.I.R. 1960 Pat 252.
35. (1961) 42 I.T.R. 129 (Patna).
36. (1965) 56 I.T.R. 172.

that there is a difference between 'concealed income' and 'giving inaccurate particulars of income'and that it is only in the latter clause that the element of deliberation is required[37]. Concealment is proved, when it is established that there was income and that it was not disclosed in the return.

In an earlier case of Lal Chand Gopal Das v. C.I.T., U.P. and V.P.[38], the matter was debated with much ingenuity. During the assessment year 1946-47 the Income Tax Officer discovered a sum of Rs. 5,000 entered as deposited, in the amanat khata (cash register) of the assessee. The book showed that the cash was received from a businessman but the name of the man was not mentioned. On enquiry the assessee failed to give any satisfactory account of the sum. His explanation, that as four years had lapsed since the date of deposit, he could not remember the name of the businessman from whom temporary deposits were received, was rejected as fallacious. Accordingly, the Income Tax Officer added the sum, as concealed income of the assessee from the business.

---

37. See supra p.289 Until March 31st, 1964, section 271(1)(c) contained 'deliberately' in the latter part of the clause. This is now deleted w.e.f. the 1st April, 1964. by the Finance Act, 1964.
38. (1963) 48 I.T.R. 324 (All); Mohan Ram Ram Kumar v. C.I.T. U.P., (1966) 59 I.T.R. 135 (All) Messrs. Dwarka Prasad Sheo Karan Das v. C.I.T., U.P. A.I.R. 1954 All 123.

It was held that the omission of the assessee to place materials before the Department to enable it to hold otherwise, constituted the materials on the basis of which the Department could legitimately draw the inference that the amount was concealed income within section 28(1)(c).

The Andhra Pradesh High Court in Subba Raju v. C.I.T., Madras (Now Hyderabad)[39] held that non-disclosure of material fact amounts to concealment within section 28(1)(c) of the Act.

The assessee, a firm, operating as a military contractor, submitted a return of Rs. 19,639/- for the assessment year 1944-45. The Income Tax Officer called for their accounts and on examination, found that they were defective, so he added a sum of Rs.54,455/- to the amount returned, which was reduced to Rs. 35,354/- on appeal. The authorities assigned three reasons for rejecting the assessee's account book, viz., the assessee did not disclose the sale proceeds of two wagon loads of coal, Rs, 1,000, in the account books; the muster rolls produced by the assessee for wages did not seem to have been maintained in the usual course of business and that no vouchers were produced for the purchase of some material and payment of cartage. The Income Tax Officer, being satisfied that the assessee had

---

39. A.I.R. 1955 Andhra 281; C.I.T., A.P. v. Messrs. Royala-Seemo Oil Mills A.I.R. 1971 A.P. 34.

concealed part of his income, imposed a penalty under section 28(1)(c) of the Act of 1922.

The appellant contended that the finding recorded related only to the non-disclosure in the accounts of the sale of two waggon-loads of coal; a penalty could be levied in respect only of concealed income, so no penalty could be levied under section 28(1)(c) of the Act.

The Court rejected the appellant's contention and said:

> "... [The appellant's contention] ignores the express language of the section. The finding necessary,... for the liability to penalty in a case like this, is concealment of particulars of income or deliberately furnishing of inaccurate particulars of such income. Once that finding is recorded, it seems... that it was open to the appropriate authority to levy ... penalty ..."[40]

In another case of <u>Mareddi Krishna Reddy</u> v. <u>I.T.O, Tenali</u>[41], the Court went a step further and made it abundantly clear that <u>mens rea</u> is not required in every case of default under the Income Tax Act.

The appellant was a partner of the registered firm of Messrs. Talluri Suryanarayan. The firm carried on business in milling paddy from January 15, 1945 to December 28, 1947, after which it discontinued its business. On August 7, 1950, Talluri Suryanarayan filed a return on behalf of the firm disclosing an income of Rs. 2,389 for

---

40. A.I.R. 1955 A.P. 281,282, para 4.
41. A.I.R. 1957 A.P. 368. Income Tax Act, 1961, section 271 (2) provides provision for imposition of penalty in Case of firms both registered and unregistered and sec. 189 imposes joint and several liability on the members of a firm in case of dissolution or discontinuance of business.

the assessment year 1947-48. During the course of the scrutiny of the accounts, the Income Tax Officer detected a substantial sum of money, which was not included in the return. The assessee admitted that some cash credits found in the accounts represented the firm's income but for other credit items the assessee had no explanation. The Income Tax Officer computed tax on a total income of Rs. 50,776 and levied a penalty under section 28(1)(c) of the Act of 1922. As the firm had discontinued business the penalty was to be realized proportionately from each of the partners.

The assessee contended that a person could only be penalized if he acted with mens rea, so a member of the firm could not be punished for a default made by another partner if the firm had discontinued business.

While rejecting the appellant's contention, Subba Rao, C.J., said:

> "...It is not an inflexible rule of law that mens rea is a necessary ingredient of every default. One of the exceptions to that rule is where an Act excluded the said factor. Section 44 specifically provides for joint assessment in the case of discontinuance of a firm. The position, therefore, is that, despite the discontinuance, all the partners would be jointly liable for assessment. If section 28 applies, the word 'person' in that section, whose default attracts the penal consequences, takes in partners jointly liable for the assessment."[42]

---

42. Ibid. 369 (para 7).

The Supreme Court of India in C.I.T., West Bengal v. Anwar Ali,[43] has approved of the view taken by the Bombay High Court in C.I.T., Ahmedabad v. Gokuldas Harivallbhdas[44], the Gujarat High Court in C.I.T., Gujarat v. L.H. Vora[45], the Madras High Court in Radha Rukmani Ammal v. C.I.T., Madras[46], and the Patna High Court in C.I.T., Bihar v. Mohan Mallah[47]. and disapproved of the Allahabad view in Lalchand Gopaldas[48]

The Income Tax Officer, while making the assessment of the respondent's income, discovered an undisclosed bank account of the assessee with the Central Bank of India at Betiah in Patna. On scrutiny, it was found that the assessee had made a cash deposit of Rs. 87,000 on 21 November 1946 in the said bank. The explanation of the assessee as to the source of the deposit, was that, during the communal riots in Bihar in the year 1946, all his relations became panicky and entrusted him with whatever cash they had for safe custody; this was found to be false and unreliable. Accordingly, the Income Tax Officer held that the sum of Rs. 87,000 represented the income of the assessee from an undisclosed

---

43. A.I.R. 1970 S.C. 1782.
44. A.I.R. 1959 Bom. 96.
45. (1965) 56 I.T.R. 126 (Guj.).
46. A.I.R. 1957 Mad. 568.
47. (1964) 54 I.T.R. 499 (Patna).
48. (1963) 48 I.T.R. 324 (All); Hazi Abdul Rehman, Abdul Qayum v. C.I.T., U.P. (1965) 56 I.T.R. 172; Mohan Ram Ram Kumar v. C.I.T., U.P. (1966) 59 I.T.R. 135 (All).

source and imposed a penalty under section 28(1)(c) of the Act for concealment of income.

Their Lordships rejected the Income Tax Department's claim and held that:

> "... [T]he mere fact that the explanation of the assessee is false does not necessarily give rise to the inference that the disputed amount represents income .... Before penalty can be imposed, the entirety of circumstances must reasonably point to the conclusion that the disputed amount represented income and that the assessee had consciously concealed the particulars of his income or had deliberately furnished inaccurate particulars."[49]

It is submitted with respect that the Supreme Court's view on the subject needs modification, in as much as the Court should not impliedly insert the word 'deliberately' before 'concealed the particulars of such income' in clause (c), of sub-section (1) of section 271, when the legislature has preferred to omit it from the time it was first enacted in Income Tax law[50]. The legislature has since deleted the word 'deliberately' occurring in the latter part of the clause as well[51]. In the light of these facts, it would be appropriate for the Supreme Court to apply the same test for the inference of 'concealment' under section 271(1)(c) of the Act of 1961, as it had applied in Malegaon

---

49. A.I.R. 1970 S.C. 1782, 1785 (para 6).
50. See <u>supra</u> p. 282 for the provision under the Income Tax Act, 1918.
51. See <u>supra</u> p. 289 for the text of the provision.

Electricity Co. (P) Ltd. v. C.I.T., Bombay[52], for the purposes of assessment of 'income escaping assessment' under section 34(1)(a) of the Act of 1922, corresponding to section 147(1)(a) of the Act of 1961[53].

The case relates to the provisions in the Act of 1922, but it will apply to the provisions of the Act of 1961 as well. The appellant sold its assets to the Amalgamated Electricity Co. (belgium) Ltd. The assessee received a sum as consideration for the sale of its assets, which was more than their written down value. The assessee informed the Income Tax Officer about the sale, but did not show in its return any profits under section 10(2)(vii) of the Act of 1922 nor did it show the amount received for the sale in excess of the written down value of the assets, section 10(2)(vii) provided that:

> "Such profits or gains shall be computed after making the following allowances, namely
> ....
> (vii) in respect of any such building, machinery or plant which has been sold or discarded or demolished or destroyed, the amount by which the written down value thereof exceeds the amount for which the building machinery or plant, as the case may be, is actually sold or its scrap value."

---

52. A.I.R. 1970 S.C. 1982; Calcutta Discount Co. Ltd. v. I.T.O. Calcutta A.I.R. 1961 S.C. 372; P.R. Mukherjee v. C.I.T. W.B. A.I.R. 1956 Cal. 197; Muthiah Chettiar v. C.I.T., Madras A.I.R. 1970 S.C. 10. See Indo-China Steam Navigation Co. v. Jasjit Sing A.I.R. 1964 S.C. 1140; A.I.R. 1964 Bom. 274.
53. See Chapter 2,p.65 for text of section.

The Income Tax Officer, being of the opinion that the profits deemed to have been earned by the assessee company under section 10(2)(vii) had not been assessed, proceeded under section 34(1)(a) to assess the income escaping assessment. Section 34(1)(a) provided that:

> "If-
> (a) the Income Tax Officer has reason to believe that, by reason of the omission or failure on the part of an assessee to make a return of his income... or to disclose fully and truly all material facts necessary for his assessment for that year, income, profits or gains chargeable to income tax have escaped assessment for that year...
> ....
> he may, in cases falling under clause (a), at any time ..., serve on the assessee, or, if the assessee is a company, on the principal officer thereof, a notice... and may proceed to assess or reassess such income, profits or gains..."

The appellant's contention that the disclosure made by the assessee was true and full in all material particulars inasmuch as it had placed before the Income Tax Officer all the material facts for the assessment so that no proceedings could be taken under section 34(1)(a) of the Act, was rejected. It was held that the failure of the assessee to disclose to the Income Tax Officer the fact that the price realized by it by sale of its assets was more than the written down value of those assets, amounted to a failure on its part to disclose, fully and truly, the material facts necessary for its assessment. The Income Tax Officer, therefore, could commence proceedings, under section 34(1)(a) of the Act, on the ground that the entire profits deemed to have been earned under section 10(2)(vii) had escaped assessment.

Similarly, a person should be deemed to have 'concealed the particulars of income', if he does not disclose fully and truly all material facts or adduce a satisfactory explanation as regards the nature of the income discovered. This proposition is supported by the 'Explanation clause' attached to section 271(i)[54] of the Act, which provides as follows:

> "Where the total income returned by any person is less than eighty per cent of the total income...as assessed ...such person shall, unless he proves that the failure to return the correct income did not arise from any fraud or any gross or wilful neglect on his part, be deemed to have concealed the particulars of his income or furnished inaccurate particulars of such income for the purposes of clause (c) of this sub-section.

Furnishing of Inaccurate Particulars

As noted earlier, the word 'deliberately' was originally included in the later part of the clause[55], so that a man was not to be held liable for furnishing inaccurate particulars of income in the return[56] unless it

54. The Explanation clause was added by the Finance Act, 1964, with effect from the 1st April, 1964.
55. See supra pp. 286-87.
56. Kaloogala Estate Namunugalaby Partner A.K. Chettiar, Ceylon v. C.I.T., Madras (1966) 1 M.L.J. 23. It was held that 'particulars of income' is wide. It does not simply cover cases where details concerned with the trading activities are not disclosed or are inaccurately disclosed, but includes also the overall effect achieved by any improper method adopted by the assessee. H.D. Rajah v. C.I.T., Madras A.I.R. 1965 Mad. 374.

was proved that he had a guilty mind. The Courts applied the common law doctrine of mens rea in adjudicating cases under the provision. The imporatant question that arises in this connection is whether the subsequent omission of the word 'deliberately' from the clause has made any significant change in the assessee's liability for a penalty. Two diametrically opposite views may be noted in this regard.

The proponents of one view maintain that the omission of the word 'deliberately' from the latter part of the clause (c) of sub-section (1) of section 271 of the Income Tax Act, 1961, has made no difference as regards the assessee's penal liability for 'furnishing inaccurate particulars of income' are concerned. The assessee's liability under the clause will be the same as before the amendment of the provision. In other words, the penalty cannot be imposed on an assessee, unless it is proved beyond doubt that the 'furnishing of inaccurate particulars of such income' was intentional and that the assessee was conscious of the commission of the offence at the time when it was being committed. It is said that, though the word 'deliberately' does not appear in the first part of clause (c) of sub-section (1) of section 271 of the Act of 1961 (and section 28 of the Act of 1922), it was implicit in the word 'concealment'. Similarly, the presence of the word 'deliberately' would be inferred in the latter part of the clause before 'furnished inaccurate particulars of scuh income'

Reliance is placed on the decision of the Madras High Court in Radha Rukmani Ammal v. C.I.T., Madras[57] and other cases discussed earlier[58] in support of this view. The emphasis is directed towards the statement of Rajgopalan J., in Hadha Rukmani Ammal case that:

> "... Notwithstanding the absence of the qualifying word 'deliberately' in the first alternative referring to concealment, undoubtedly the concealment also has to be conscious and so a deliberate act, which is involved on the very expression 'concealed'." [59]

According to the other view, the omission of the word 'deliberately' from the latter part of the clause (c) and the addition of an explanation at the end of sub-clause (iii) of sub-section (1) of section 271 of the Act of 1961 is of special significance. It is maintained that the legislature in India for the first time has taken a bold step to ensure that the tax dodgers, enemy No. I in Indian society, may not take shelter behind the established criminal law doctrine of mens rea, which is now completely excluded from consideration when the assessee has 'furnished' inaccurate particulars of income'. The combined effect of the amendment is that the penalty can now be imposed, even if the furnishing of inaccurate particulars of income' is not intentional, but is the result of gross or wilful

---

57. A.I.R. 1957 Mad. 568.
58. See supra pp. 301-4 for other cases.
59. A.I.R. 1957 Mad. 568, 570 (para 9).

neglect[60] or is accidental[61]. The Explanation clause makes a drastic change in the procedure, inasmuch as the burden of proof is cast upon a taxpayer where the income returned by him turns out to be less than 80 per cent of the income assessed.

This view appears to be more appropriate and in conformity with the object of the legislation.

It is submitted that whether there has been 'concealment' or 'furnishing of inaccurate particulars of income' is a question of fact to be determined in the circumstances of each case[62]. No hard and fast rule can be laid down. The relevant facts are the magnitude of the amount omitted, the method of accounting adopted, the nature of the transactions and the evidence adduced by the assessee.[63]

---

60. 'The Law and Practice of Income Tax', J.B. Kanga and N.A. Palkhiwala (6th ed. 1969) Vol.I, p. 1038.
61. 'Penalty Provisions under the Income Tax Act and Wealth Tax Act- Legal Aspects of Implications and Justification of Recent Changes; Report on 3rd All India Conference of Tax Executives, R.S. Gae. (1968) p.104. R. Prasad Mohan Lal v. I.T.A. Tribunal, A.I.R. 1970 All 620, 630 (para27) (F.R.).
62. C.I.T., M.P., Nagpur v. Punjabhai Shah Chindwara, A.I.R. 1968 M.P. 103; re Lachmondas Brajballabhbas, 1942 I.T. R. 186 (All); Lachmindra Mahrchand v. Income Tax Appellate Tribunal, 1944 I.T.R. 432 (Lahore); C.I.T., Madras, v. V.V. Venaktaramiiah, A.I.R. 1943 Mad. 579, 581.
63. Supra note 82, at p. 910. Appavoo Pillai v. C.I.T., Madras A.I.R. 1965 Mad. 406; C.I.T., A.P. v. M/s.Rayalaseema Oil Mills, A.I.R. 1971 A.P. 34 see Cliford v. I.R.C., (N.Z.) (1966) A.I.T.R. 35; C.I.R. v. Frethey, (1961) N.Z.L.R. 245. It was held that substantial understatement of income may by themselves furnish evidence of guilt. See 'Current Problems in Tax Fraud', Paul P. Lipton, 1955. Wisconsin L.R. 416, 438.

The Courts will not ordinarily interfere with the amount of the penalty imposed by the Income Tax authorities under the clause, unless their discretion has been exercised arbitrarily[64].

Failure to Furnish Returns or Comply with Notices

The provision relating to the imposition of a penalty for failure to furnish a return of income in time, as required under the Act, and to comply with notices to produce accounts, documents and other information for the purposes of assessment was put on the statute book in 1939. The Income Tax (Amendment) Act, (7 of 1939) added clauses (a) and (b) to sub-section (1) of section 28 of the Act of 1922 and provided a penalty for such defaults. The Income Tax Act, 1961, has reproduced those provisions with some modifications in clauses (a) and (b) of sub-section (1) of section 271. These provisions are as follows:

> "Section 271(1) If the Income Tax or the Appellate Assistant Commissioner, in the course of any proceedings under this Act, is satisfied that any person -
>
> (a) has without reasonable cause failed to furnish the return of ( )[65] total income, which he was required to furnish under sub-section (1) of section 139 or by notice given under sub-section (2) of section 139 or section 148 or has without reasonable cause, failed to furnish it within the time allowed and in the manner

---

64. Re Gopaldas Purshottam Das (1941) 9 I.T.R. 372 (All).

65. The word 'his' was deleted by the Income Tax (Amendment Act (13 of 1963).

required by sub-section (1) of section 139 or by such notice, as the case may be, or

(b) has without reasonable cause failed to comply with a notice under sub-section (1) of section 142 or sub-section (2) of section 143,

....

he may direct that such person shall pay by way of penalty, -

(i) in the cases referred to in clause (a), in addition to the amount of tax, if any, payable by him, a sum equal to two per cent, of the tax for every month during which the default continued, but not exceeding in the aggregate fifty per cent of the tax;

(ii) in the case referred to in clause (b), in addition to any tax payable by him, a sum which shall not be less than ten per cent but which shall not exceed fifty per cent of the amount of the tax, if any, which would have been avoided if the income returned by such person had been accepted as the correct income."

The present provision differs from the corresponding provisions of the Act of 1922 (Section 28(1)(a) and (b), in two respects. Firstly, it provides for imposition of minimum penalty in cases of defaults committed under clauses (a) and (b) of section 271(1). There was no such provision in the Act of 1922. Secondly, the maximum penalty imposable has been reduced as compared with the corresponding clauses of section 28(1) of the Act of 1922[66].

Unlike clause (c) of sub-section (1) of section 271, clauses (a) and (b) recognize 'reasonable cause'[67] as a good excuse for defaults committed under the clauses.

---

66. See *infra* p.322 for S.28(1) (a) and (b).
67. Similar defence is available in the case of criminal prosecution under sections 276,276A and 276B of the Act. See Chapter 8, pp.354,363-5 and Chapter 2 pp. 55-67 for meaning of 'reasonable and sufficient cause'.

Clause (a) provides for the imposition of a penalty for failure to furnish a return. It contemplates two kinds of default, viz., one committed when no notice is given and the other committed after notice[68]. For instance, the former part of the clause provides for the imposition of a penalty in case of default committed under section 139(1) of the Act, which creates a statutory obligation to furnish a return of income suo motu[69], by or before a particular date, whereas the latter part of the clause provided penalty for failure to file a return after due notice under section 139(2)[70], or section 148[71] or after expiry of the time allowed beyond the statutory limit provided in section 139(1) of the Act.

In C.I.T. Rajasthan v. Messrs. Indra and Company, Jodhpur,[72] the question was whether the assessee's fault of failure to file a return of income, suo motu, as required under section 139(1) of the Act, is condoned by the submission of a return in reply to the Income Tax Officer's notice under section 139(2) of the Act.

---

68. C.I.T. Rajasthan v. Messrs. Indra and Company A.I.R. 1970 Raj. 207, 209 (para 3).
69. There was no such provision in the repealed Act of 1922, see chapter 2, pp 30,31.
70. See Chapter 2, p.49 for section 139(2).
71. Income Tax Act, 1961, section 148 authorizes the Income Tax Officer to issue notice for reassessment where income has escaped assessment.
72. A.I.R. 1970 Raj. 207.

The respondent, a registered firm, and one of its partners, Jivalal Maheshwari, did not submit their income tax returns as required under section 139(1) of the Act on or before the 30th June 1962. They asked for an extension of time for filing their returns several times, though this was granted no return was filed, until after a notice under section 139(2) of the Act, they filed a return on 25.4.63. During the course of assessment, the Income Tax Officer issued notices to the assessee to show cause why a penalty should not be imposed for failure to submit the return under section 139(1) of the Act. In the absence of a reasonable explanation, the Income Tax Officer imposed a penalty under section 271 (1)(a) of the Act.

The Court rightly rejected the assessee's contention that, as soon as notices under section 139(2) of the Act were issued, the delay in filing the returns under section 139(1) was condoned by the Income Tax Officer, so that no action could be taken against him for not filing the returns in time as laid down in section 139(1) of the Act. Their Lordships declined to recognize the theory of implied condonation. Bhadari, C.J. delivering the judgement of the Court, said that:

> "...Unless there is any express order for condonation of such default, we cannot take it that the Income Tax Officer, merely because he has issued a notice under Section 139(2) to a person who has not filed the return under section 139(1) must be taken to have condoned his default in not furnishing the return under Section 139(1)[73]

---

73. Ibid. p. 209 (para 6)

Clause (b) of sub-section (1) of section 271 of the Income Tax Act, 1961, provides for the imposition of a penalty in case of failure to produce accounts, documents, total wealth statements and other information and for failure to attend at the Income Tax Officer's office or to produce evidence on which he relies in support of the return, on receipt of a notice issued under sections 142(1) and 143(2) of the Act.

In the fairly recent case in the Mysore High Court of Narayanappa and Brothers v. C.I.T., Mysore[74], (under the repealed Act of 1922), the question was whether the Income Tax authorities can levy penalties on an assessee both under clauses (a) and (b) of sub-section (1) of section 28, when the assessee has committed a default by not filing a return at all, though required to do so by a notice under section 22(2)[75] of the Act and by further not complying with a notice under section 22(4)[76] of the Act of 1922.

The assessee, a Hindu undivided family, committed default in furnishing its return for the assessment years 1951-52 to 1954-55, in spite of a notice issued under sections 22(2) and 22(4). Accordingly, the Income Tax Officer completed the assessment under section 23(4)[77] of

74. I.L.R. (1961) Mysore 77.
75. Income Tax Act, 1922, section 22(2) provided provisions similar to that of section 139 (2) of the Act of 1961.
76. Income Tax Act, 1922, section 22(4) corresponds to section 142(1) of the Act of 1961. See Chapter 2 p. 50.
77. Income Tax Act, 1922, section 23(4) provided for 'best judgement assessment'. Section 144 of the Act of 1961 contains similar provisions. See Chapter 2, pp.51-52.

the Act. Thereafter the Income Tax Officer issued notices to show cause why penalties should not be imposed for failure to furnish a return under section 22(2) and for failure to produce accounts, as required by notice under section 22(4); after hearing the assessee, the Income Tax Officer imposed penalties under both clauses, 28(1)(a) and 28(1)(b) of the Act. The relevant portions of sub-clause (a) and clause (b) provide:

> "28(1). If the Income Tax Officer... is satisfied that any person-
>
> (a) has without reasonable cause failed to furnish the return of his total income which he was required to furnish by notice given under ... sub-section (2) of section 22, or ... , or
>
> (b) has without reasonable cause failed to comply with a notice under sub-section (4) of section 22 ...
>
> ...
>
> he ... may direct that such person shall pay by way of penalty, in the case referred to in clause (a), in addition to the amount of the income tax and super tax, if any, payable by him, a sum not exceeding one and a half times that amount, and in the case referred to in clauses (b) ..., in addition to any tax payable by him, a sum not exceeding one and a half times the amount of the income tax and super tax, if any, which would have been avoided if the income as returned by such person had been accepted as the correct income."

The assessee conceded liability under clause (a) of sub-section (1) of section 28, but not under clause (b) of sub-section (1) of section 28. He contended that no penalty could be imposed under section 28(1)(b) for failure to produce accounts when called upon to do so under section 22(4), until such failure preceded by the furnishing of a return under section 22(2) of the Act, because, it would not be possible to calculate the penalty under the provisions of the Act, if there was no return at all.

The Court agreed with the assessee and answered the question in the negative. The Court said that:

> "... [W]here a penalty is proposed to be imposed under section 28(1)(b), the maximum penalty which could be so imposed is a sum representing one and a half times the difference between the tax payable on the income returned by the assessee and the tax payable on the income as determined under the Act. The two factors, on the basis of which the amount of the penalty payable can be determined by the Income Tax Officer, are the tax payable by the assessee on the return furnished by him and the tax as determined by the Income Tax Officer by the assessment made by him under the Act. If an assessee did not at all furnish a return to the Income Tax Officer, though called upon to do so under section 22(2), one of the factors which should form the basis for the quantification of the penalty being non-existent, it seems ... clear that it would not be possible at all for an Income Tax Officer to impose any penalty on such assessee .... [T]he words "the income as returned by such person' (as used under section 28(1)(b))... make it clear that for the imposition of penalty under section 28(1)(b) the indispensable condition precedent is that before the assessee commits the default referred to in section 28(1)(b), such default must have been preceded by the production of a return under section 22(2)".[78]

It is submitted, with respect, that the High Court view needs revision. The two faults under clause (a) and clause (b) are independent of each other and they may take place simultaneously. In such a case, where the assessee has not furnished a return at all, it should be presumed for the purposes of section 28(1)(b) by legal fiction that he has furnished a return of his income informing the Income Tax Officer that his income was nil and the penalty should

---

78. I.L.R. (1961) Mysore 77 at pp. 80,81.

be calculated on that basis. Holding otherwise will encourage default in making returns and create obstacles in the calculation of the penalty under section 28(1)(b) of the Act.

In C.I.T., Delhi v. Teja Singh,[79] a somewhat similar situation arose, in which the Court held the assessee liable to a penalty under section 18 A(9)(b) read with section 28 of the Act of 1922, for failure to submit the estimate of advance tax, as required under section 18A(3). It was held that the failure to submit an estimate of advance tax amounted to a failure to file a return by legal fiction and that the necessary notice was issued for the purpose of imposing a penalty.

Failure to Furnish Information Regarding Securities, Dividends and Discontinuance of Business.

As discussed earlier[80], the Income Tax Act, 1961, has made provision in sub-section (1) and sub-section (2) of section 94 to prevent tax avoidance by certain transactions in shares and securities, known as bond-washing and sale of securities cum-interest or shares cum-dividend. In order to facilitate the cumbersome and difficult task of checking tax avoidance, sub-section (6) of section 94 has empowered the Income Tax Officer to issue a notice in order to extract the necessary information in this regard from an assessee. Sub-section (6) states:

---

79. A.I.R. 1959 S.C. 352. See infra pp. 330-31.
80. See Chapter 3, pp. 86, 122.

"The Income Tax Officer may, by notice in writing, require any person to furnish him within such time as he may direct (not being less than twenty-eight days), in respect of all securities of which such person was the owner or in which he had a beneficial interest at any time during the period sepcified in the notice, such particulars as he considers necessary for the purpose of this section and for the purpose of discovering whether income tax has been borne in respect of the interest on all those securities."

Compliance with the notice is obligatory on the part of the assessee. In case of failure to furnish the information, required, the assessee would be liable to a penalty under section 270 of the Act of 1961, which states:

"... such person shall pay by way of penalty a sum not exceeding five hundred rupees and by way of further penalty a like amount for every day after the infliction of such penalty during which the failure continues."

Similar provisions regarding penalties are found in sub-section (6) of section 44E and sub-section (5) of section 44F of the repealed Income Tax Act of 1922.

Section 176 of the Income Tax Act, 1961, gives power to the Income Tax Officer to make an assessment in case of discontinuance of any business, profession or vocation, in the year of discontinuance on the entire business income from the end of the previous year relevant to the assessment year till the date of discontinuance. The Income Tax Officer need not wait for assessment until the usual financial year[81]. With a view to expedite assessment, sub-section (3) of section 176 makes it obligatory on the part of the person discontinuing a business, profession or vocation, to give

81. C.I.T. v. Srinivasan and Gopalan (1953) 23 I.T.R. 87.(S.C.)

a notice of discontinuance to the Income Tax Officer within fifteen days of such discontinuance. The requirement of notice is obligatory; failure on the part of the person responsible makes him liable to a penalty under section 272 of the Income Tax Act, 1961[82]. Section 272 of the Act says:

> "Where any person fails to give notice of discontinuance of his business or profession, as required by sub-section (3) of section 176, the Income Tax Officer may direct that a sum shall be recovered from him by way of penalty, which shall not be less than ten per cent of the tax but which shall not exceed the amount of tax subsequently assessed on him in respect of any income of the business or profession up to the date of its discontinuance."

Section 272 of the Act of 1961, is distinguishable from its corresponding provision in section 25(2) of the repealed Act of 1922, in one respect. The former provides for a minimum penalty of 10 per cent of the tax in case of default under the section, whereas the latter did not provide any such minimum.

False Estimate and Failure to Pay Tax in Advance

Section 273 of the Act of 1961 provides for imposition of penalty in a case of false estimate of or failure to pay advance tax as required under the Act[83]. Section 273[84] of the Act states that:

---

82. Income Tax Act, 1922, section 25(2) corresponded to section 272 of the Act of 1961.
83. See *supra* pp.268-79 for provisions relating to the advance tax.
84. The present section has been substituted for the original section of the Act by section 22 of the Finance Act (14 of 1969) with effect from April 1, 1970. See '*Advance Payment of Tax*', B.L. Kabra, 4th All India Conference of Tax Executives (1969), p. 177.

"If the Income Tax Officer, in the course of any proceedings in connection with the regular assessment ..., is satisfied that any assessee -

(a) has furnished under section 212 an estimate of advance tax payable by him which he knew or had reason to believe to be untrue, or

(b) has without reasonable cause failed to furnish an estimate of the advance tax payable by him in accordance with the provisions of sub-section (3) of section 212, or

(c) has without reasonable cause failed to furnish an estimate of the advance tax payable by him in accordance with the provisions of sub-section (3A) of section 212, he may direct that such person shall, in addition to the amount of tax, if any, payable by him, pay by way of penalty a sum -

(i) which in the case referred to in clause (a), shall not be less than ten per cent but shall not exceed one and a half times the amount by which the tax actually paid during the financial year ... falls short of-

(1) seventy-five per cent of the assessed tax ..., or

(2) where a notice under section 210 was issued to the assessee, the amount payable thereunder, whichever is less;

(ii) ... in clause (b), shall not be less than ten per cent but shall not exceed one and a half times of seventy-five per cent of the assessed tax...; and

(iii) ... in clause (c), shall not be less than ten per cent but shall not exceed one and a half times the amount by which the tax payable under the notice issued to the assessee under section 210 falls short of seventy-five per cent of the assessed tax..."

Section 273 of the Act of 1961 differs from its corresponding provision in sub-section (9) of section 18A of the repealed Act of 1922, in two respects. Firstly, section 273 states the conditions under which a false estimate or failure to furnish an estimate of advance tax will attract a penalty and afterwards lay down the amount of penalty to be imposed in such cases, whereas section 18A(9) did not state the amount of penalty. The penalty for default contemplated under section 18(A)(9) was imposed under section 28(1) of the Act of 1922. Secondly, the penalty under section 273 could only be attracted, if the advance tax paid on the basis of the assessee's own estimate were less than 75 per cent of the tax determined on regular assessment, whereas, the proviso to sub-section (9) of section 18A[85] provided a margin of 20 per cent only.

Section 273 of the Act of 1961, like section 18A(9), contemplates an assessee's liability in two cases. In clause (a) it is dependent on the assessee's knowledge and in clauses (b) and (c) on the basis of lack of the reasonable care necessary under the circumstances[86].

In 1965, a question came before the Madras High Court in Appavoo Pillai v. C.I.T., Madras[87], a case under section 18A(9) of the Act of 1922, was whether the assessee's failure to furnish a correct estimate of advance tax would be deemed intentional so as to attract the penalty under

---

85. Income Tax Act, 1922, section 18A(9), proviso states: "Provided that the amount of penalty leviable shall, in the case referred to in clause (a), be a sum not exceeding one and a half times the amount by which the tax actually paid during the year under the provisions of this section falls short of the tax that should have been paid by the assessee under sub-section (1) eighty per cent of the tax determined on the basis of the regular assessment as modified in the manner provided in sub-section (6), whichever is less, and in the case referred to in clause (b), one and a half times the said eighty per cent."
86. N.V.N. Nagappa Chettiar v. I.T.O. Pudukattai A.I.R. 1959 Mad. 205, at p. 208.
87. A.I.R. 1965 Mad. 406.

section 28(1) of the Act.

The assessee submitted an estimate of his income in pursuance of the Income Tax Officer's demand under section 18A(1)[88] of the Act, to pay tax in advance. The assessee estimated his income from all sources at Rs. 35,515. This sum was far below the amount calculated on assessment, which amounted to Rs. 90,759. Accordingly, the Income Tax Officer imposed a penalty under section 18A(9) read with section 28(1)(c)[89], as the estimate of income was found to be untrue to the knowledge of the assessee and he did not produce any satisfactory basis for his estimate. Section 18A(9) provided as under:

> "If the Income Tax Officer, in the course of any proceedings in connection with the regular assessment is satisfied that any assessee-

---

88. Income Tax Act, 1922, section 18A(1)(a) = (Income Tax Act, 1961, section 207(1), 208(a), 209, 210(1) & (2), 211(1) provided that:

    "In the case of income in respect of which provision is not made ... for deduction of income tax at the time of payment, the Income Tax Officer may, on or after the 1st day of April in any financial year,... require an assessee to pay quarterly to the credit of the Central Government on the 15th day of June, 15th day of September, 15th day of December and 15th day of March in that year, respectively, an amount equal to one quarter of the income tax and super tax payable on so much of such income as is included in his total income of the latest previous year in respect of which he has been assessed, if that income exceeded the maximum amount not chargeable to tax in his case by two thousand five hundred rupees...."

89. See supra p. 285 for text of section 28(1)(c).

(a) has furnished ... estimates of the tax payable by him which he knew or had reason to believe to be untrue, or

(b) has without reasonable cause failed to comply with the provisions of sub-section (3),
the assessee shall be deemed, in the case referred to in clause (a), to have deliberately furnished inaccurate particulars of his income, and in the case referred to in clause (b), to have failed to furnish the return of his total income; and the provisions of section 28, so far as may be, shall apply accordingly."

It was rightly held that the disparity between the estimate (Rs.35,515) and the finally assessed figure (Rs. 90,759) was so great that it left no room for doubt that the under-estimate was deliberate and intentional. The contentions that the assessee thought his estimate represented the probable income and that it was made honestly could not be accepted under the circumstances.

In C.I.T., Delhi v. Teja Singh[90], (a case under the Act of 1922) the question which arose before the Supreme Court was whether the Income Tax Officer could impose a penalty under section 18A(9)(b) read with section 28(1)(a)[91] on a person, who had failed to furnish an estimate of advance tax payable under section 18A(3)[92] within the time required.

---

90. A.I.R. 1959 S.C. 352.
91. See supra p.322 for the text of section 28(1).
92. Section 18A(3) provided that:
"Any person who has not hitherto been assessed shall before the 15th day of March in each financial year, if his total income of the period ... is likely to exceed the maximum amount not chargeable to tax in his case by two thousand five hundred rupees, send to the Income Tax Officer an estimate of the tax payable by him ... and shall pay the amount, on such of the dates specified ..."

The assessees (two in number), who had not previously been assessed, submitted returns of their income '<u>suo motu</u>'under section 18A(3) of the Act. As the returns were submitted after the 15th day of March which concluded the'statutory period' within which the estimate had to be filed, the Income Tax Officer imposed a penalty under section 18A(9)(b) read with section 28(1) of the Act.

The assessee contended (and the High Court agreed) that liabilitby under section 18A(b) read with section 28(1)(a) accrued only when a person failed to furnish the return he was required so to do by notice under section 22 or section 34, and no such notices could be issued with reference to estimates of tax on income to be sent under section 18A(3).

Their Lordships, while rejecting the appellant's contention held that the failure to send an estimate of Tax under section 18A(3) is treated as failure to furnish a return of income under section 22 by a legal fiction and the true effect of that fiction is that it imports that notice has been issued. Venkatarama Aiyar, J., speaking for the Court said:

> "... On the construction contended for by the respondent, S. 18A(9)(b) would become wholly nugatory, as Ss. 22(1) and 22(2) can have no application to advance estimates to be furnished under S. 18A(3), and if we accede to this contention, we must hold that though the legislature enacted S. 18A(9)(b) with the very object of bringing the failure to send estimates under S.18A(3) within the operation of S.28, it signally failed to achieve its object. A contruction which leads to such a result must, if that is possible, be avoided on the principle expressed in the maxim,

'<u>ut res magis valea quam pereat</u>', Vide <u>Curtis</u> v. <u>Stovin</u> (1889) 22 Q.B.D. 513."[93]

However, as the present Act of 1961 has provided a penalty under a separate section 273, unlike the Act of 1922, for failure to submit a return, no difficulty can now arise.

<u>Penalties Outside Chapter 21</u>.

The Act of 1961 provides penalties in three cases, which are not covered by Chapter 21. These are:

(i) For failure to comply with the provisions of a summons issued by an assessing officer;

(ii) For failure in payment of tax on self-assessment and

(iii) For non-payment of tax.

Sub-sections (1) and (3) of section 131[94] of the Act confer the powers of a court of law on the Income Tax authorities in regard to discovery and inspection, production of books, evidence and eliciting of information necessary for proper levying of taxes[95]. And sub-section (2) provides for the imposition of a fine in case of failure to comply with such orders. There was no such provision in the earlier Act of 1922. Sub-section (2) of section 131 states:

---

93. A.I.R. 1959 S.C. 352 at pp. 355,356 (para 9).
94. The provisions of this section correspond to sub-sections (1) and (3) of section 37 of the Act of 1922.
95. <u>Supra</u> note 60, p. 685. <u>Union of India</u> v. <u>State</u> (1961) 42 I.T.R. 753; <u>Ganpatrai Rawatmull</u> v. <u>Collector of Land Customs</u> (1961) 42 I.T.R. 107.

"...[W]here a person to whom a summons is issued either to attend to give evidence or produce books of account or other documents at a certain place and time, intentionally omits to attend or produce the books of account or documents at the place or time, the Income Tax authority may impose upon him such fine, not exceeding five hundred rupees, as it thinks fit,..."

This is a step in the right direction and will go a long way towards helping the authorities to get the necessary evidence for ascertaining the veracity of the assessee's return of income.

In 1964, section 140A relating to self-assessment, was inserted by the Finance Act (5 of 1964), in the Act of 1961, with effect from the 1st April, 1964.[96] Sub-section (1) of section 140A makes it obligatory on the part of an assessee, who makes a return of his total income under section 139, if the tax payable on the basis of the said return less any tax already paid exceeds Rs.500, to pay the sum due within thirty days of furnishing the return. Non-fulfilment of the statutory requirement makes the assessee liable to a penalty, which may extend to 50 per cent of the amount of tax unpaid under sub-section (3) of section 140A. Section 140A (3) states as follows:

"If any assessee fails to pay the tax or any part thereof in accordance with the provisions of sub-section (1), he shall, unless a provisional assessment

96. Similar provisions are contained in the United States of America. See 'Self Assessments'. Personal Income Tax: The American System, Harry G. Johnson (1971) B.T.R. 78-85. Self assessment has been introduced in limited cases in the United Kingdom with effect from October 5, 1970. See (1970) British Tax Review p.282.

> under section 141 or a regular assessment under section 143 or section 144 has been made before the expiry of thirty days..., be liable, by way of penalty, to pay such amount as the Income Tax Officer may direct, so however, that the amount of penalty does not exceed fifty per cent of the amount of such tax or part, as the case may be:
> Provided that before levying any such penalty the assessee shall be given a reasonable opportunity of being heard."

The liability for failure to pay tax appears to be absolute, inasmuch as the legislature has not included such words as 'deliberately', 'knowingly', or 'without reasonable cause or excuse' as in other penal provisions in the Act[97]. This view receives support from the use of the word 'shall' in the clause, i.e., Income Tax Officer <u>must</u> impose the penalty 'unless a provisional assessment... has been made'. However, in the absence of any case on the point it remains to be seen how the courts will interpret the clause.

The Income Tax Act, 1961, in section 221, like the earlier Income Tax Acts of 1922[98], 1918[99] and 1886[1] provides penalties for default in making payment of tax, including advance tax. Section 220 states that any tax, interest, penalties, fines or any other sum specified in the notice of demand under section 156 should be paid within 35 days of

---

97. See sections 270,271(1)(a), (b) and (c), and 273, at pp. 325, 317-18, 286-87 and 327 respectively.
98. Income Tax Act, 1922, sections 46(1) and 46(1A).
99. Income Tax Act, 1918, section 36(1).
1. Income Tax Act, 1886, Section 30(1).

the service of the notice, unless a shorter period is notified under the proviso to sub-section (1) of section 220. An assessee who does not pay the tax due or advance tax[2] so demanded within the period specified in the notice of demand or the extended time[3] is deemed to be in default and is required to pay the penalty under section 221 of the Act. Section 221 provides that:

> "221.(1). When an assessee is in default or is deemed to be in default in making a payment of tax, he shall, in addition to the amount of the arrears and the amount of interest payable under sub-section (2) of section 220, be liable to pay, by way of penalty, an amount which, in the case of a continuing default, may be increased from time to time, so, however, that the total amount of penalty does not exceed the amount of tax in arrears:
> Provided that, before levying any such penalty, the assessee shall be given a reasonable opportunity of being heard."

In order to attract the penalty under section 221, two conditions must be satisfied. One is that notice must be given and the other is failure to pay the tax[4]. Section 221 is wide enough to impose a penalty in case of failure

---

2. Income Tax Act, 1961, Section 218 states that:
"218(1) If any assessee does not pay on the specified date any instalment of advance tax that he is required to pay ..., he shall be deemed to be an assessee in default in respect of such instalment or instalments.
(2) If any assessee has sent an estimate or a revised estimate of the advance tax payable by him, but does not pay any instalment in accordance therewith on the date or dates specified,... he shall be deemed to be an assessee in default..."
3. Income Tax Act, 1961, section 220(3).
4. C.I.T. v. Mohd. Abdul Rahiman Sait A.I.R. 1960 Ker. 345, 346. Additional Income Tax Officer v. E. Alfred A.I.R. 1962 S.C. 663, at p. 666 (para 8).

of payment of any tax, including advance tax[5] and tax payable under a provisional assessment[6]. An assessee is deemed to be in default if he fails to pay a particular instalment of advance tax on the due date, in the same way as if no tax had been paid and the assessee will incur a penalty on that account[7]. The subsequent revision of a statement does not wipe out default in payment of an instalment due[8].

The Supreme Court held in Additional Income Tax Officer v. E. Alfred[9] the word 'assessee in default' in section 46(1) of the Act of 1922, analogous to section 221(1) of the Act of 1961, is wide enough to include 'legal

---

5. S. Narayanappa and Brothers v. I.T.C. A.I.R. 1960 Mysore 40. It was held that advance tax, being a tax in relation to the income of the assessee, was to be regarded as income tax. It is submitted with respect that the contrary view held by the Income Tax Appellate Tribunal, Delhi Bench 'C', Ahmedabad in Income Tax Appeal No. 15576 of 1964-65 decided on 23.2.1968 (as reported in 4th All India Conference of Tax Executives, 1969, p.184), is incorrect.
6. Income Tax Act, 1961, section 233.
7. A.K.Bashu Sahib v. I.T.C. (1967) 66 I.T.R. 20; J.N. Dutt v. C.I.T., Bihar and Orissa A.I.R. 1959 Pat 34.
8. Ibid.
9. A.I.R. 1962 S.C. 663; C.I.T. Kerala v. Mohd.Abdul Rahiman Sait A.I.R. 1960 Ker 345. It was held that a penalty could not be imposed on the heir of the deceased. It is submitted the decision does not hold good in view of the Supreme Court's judgement.

representatives'[10]. A legal representative will be liable for default in payment of tax due in the same manner and to the same extent as an ordinary assessee would be liable under the same circumstances[11].

An assessee must be given a reasonable opportunity of being heard, before imposition of the penalty under this section [12]. The order imposing a penalty must specify the amount of penalty , and the exact date for payment of tax. An assessee will not be liable for failure to pay the tax on the due date if the Income Tax Officer makes a mistake in mentioning the date of payment in his order.

In K.M. Abbu Chettier v. Income Tax Officer[13], a notice was issued against the assessee under section 18A

---

10. Income Tax Act, 1961, section 2(29) states that 'legal representative' has the meaning assigned to it in section 2(11) of the Code of Civil Procedure, (5 of 1908), which runs as follows: 'Legal representative' means a person who in law represents the estate of a deceased person, and includes any person who intermeddles with the estate of the deceased and, where a party sues or is sued in a representative character, the person on whom the estate devolves on the death of the party so suing or sued".
11. Section 159 deals with liability of 'Legal representative' Sukumar Mukherjee v. C.I.T. (1958) 33 I.T.R. 231; Madhu Appa Rao v. I.T.O.(1959) 36 I.T.R. 140 C.R. Nagoppa v. C.I.T.A.I.R. 1969. S.C. 888
12. There was no such provision in the Act of 1922. N.N. Kotak v. C.I.T., Bombay City A.I.R. 1952 Bom. 242
13. A.I.R. 1958 Mad. 388.

pay advance tax for the year 1952-53. The Income Tax Officer when fixing the date for payment of the instalments instead of specifying the 15th September 1954, 15th December 1954 and 15th March, 1955, as the due dates, specified the corresponding dates of the succeeding year. The Assessee did not make any payment on 15.9.1954 and the Income Tax Officer imposed a penalty for default in payment of tax. It was held that no penalty could be imposed for failure to pay the tax on 15th September, 1954, because the date mentioned was 15th September, 1955.

There is a difference of opinion amongst the Allahabad and the Kerala High Courts regarding the question whether a penalty can be levied for default in payment of a penalty already imposed.

The Allahabad High Court in Choteylal, Kanpur v. I.T.O., 'C' Ward, Allahabad[14], relying on the decision of the Supreme Court in C.A. Abraham v. I.T.C., Nottayam[15], and C.I.T., Andhra Pradesh v. Messrs. Bhikaji Dadabhai[16], that the penalty imposed in assessment proceedings amounts to additional tax, held that the penalty could be imposed for non-payment of the penalty.

---

14. (1962) 46 I.T.R. 762 (All).
15. A.I.R. 1961 S.C. 609.
16. A.I.R. 1961 S.C. 1265.

On the other hand, the Kerala High Court expressed its dissent from the Allahabad view in P. Kunhalumma v. I.T.O., B 'Ward', Calicut.[17] The Court, relying on its earlier decisions in Padmanabha Menon Krishan Menon v. C.I.T. Bangalore[18], and M.W. Mathew v. IInd Additional I.T.O., Kottayam[19], held no penalty could be imposed for non-payment of penalty.

It is submitted, with great respect, that the Kerala view does not appear to be sound or in conformity with the basic canons of construction of penal provisions. The relevant penal provision would be frustrated, if no sanction could be imposed in cases of flagrant evasion of provisions of law. It is perhaps with this end in view that section 221 itself provides for an additional 'penalty' in case of continuing default[20].

---

17. A.I.R. 1967 Ker. 173.
18. (1957) 32 I.T.R. 651.
19. A.I.R. 1956 Trancore Cochin 184.
20. See supra p.335 for section 221.

CHAPTER VII

CRIMINAL SANCTIONS

Penalties Provided in Earlier Income Tax Acts.

As is evident from its title, the present chapter is concerned with questions of criminal liability for tax crimes.

While the object of administrative sanctions is to safeguard the revenue by rendering evasion unprofitable and to reimburse the State for heavy losses caused by evasion and avoidance[1], the aim of criminal sanctions is to discourage future violations[2], to enforce public justice, to punish the offender for deliberate infractions of the law[3] and to enforce payment of the tax and the penalty[4]. Criminal sanctions, unlike administrative sanctions[5], are specific penalties

---

1. Sivagamintha Moopanar and Sons v. I.T.O., Madurai, (1955), 28 I.T.R. 601 at p. 609. Helvering v. Charles E. Mitchell, (1938) 303 U.S.391 at p. 401.
2. "Fraud and Federal Income Tax in the United States", Harold M. Groves and Arthour M. Selle Jt., 7. Bulletin for International Fiscal Documentation, 1953, p.235; "Fraud on Federal Income Tax", Myron L. Gordon, 32, Marq. L.R. 120; "Law of Federal Income Taxation", Randolph E. Paul Jacob Mertens, Vol.5. (1934), section 48.44 at p. 457.
3. Supra note 1.
4. T.S. Baliah v. T.S. Rangachari, A.I.R.(1969) Mad. 145 at p. 154 (para 49).
5. See chapter 6 for administrative sanctions.

of fine and imprisonment[6] enforced by prosecution[7].

It may be noted that the Income Tax statutes in India provided criminal sanctions long before they recognized the feasibility of imposing administrative sanctions[8]. As long ago as 1869[9], the Income Tax Act of that year (9 of 1869) provided a criminal penalty for failure of an assessee to pay tax as required under the Act. Section 25 of the Act of 1869 provided,

> "If any person served with a notice...does not, within the period specified in the said notice, pay the amount required thereby, he shall on conviction before a Magistrate be fined twice the amount mentioned in such notice...[10]

Since then the legislature in India has progressively tightened this system of control. However, it will be a long time before material success is achieved.

The criminal sanctions for violation of income tax provisions in India, as in the United Kingdom[11], United

---

6. 'Law of Federal Income Taxation', Randolph E. Paul, Vol.5, (1934) section 48.02, p. 416; "Criminal Liability for Evasion of Federal Income Taxes, (1941), 86 L. ed. 392,
7. See chapter 6, f.n. 7, at page 263.
8. The administrative sanction was provided for the first time in 1918 (by Act 7 of 1918) in section 24, whereas criminal sanction was provided in 1886 (by the Act 2 of 1886) in sections 34 to 38 of the Act.
9. See Chapter 2, p. 71 for history of taxes.
10. Quoted from The Queen v. Mudheo Dutt, (1884), 14. W.R. p.7.
11. 'Halsbury's Laws of England, Vol. 20, 3rd ed. (Simons Edition) 1957, paras 1448, 1449 at p.720.

States of America[12] and Australia[13] may be classified in two categories, those within the Income Tax Act, and those outside it.

Criminal penalties, unlike administrative penalties, which remained scattered all over the Act until the enactment of the Indian Income Tax Act, 1961,[14] had a distinct and conspicuous place in the Income Tax Acts since the beginning of such legislation. This is evident from the fact that the Income Tax Act, 1886, the first general All India Income Tax Act, incorporated criminal provisions under a separate heading, 'Penalties', in Chapter 5 of the Act, dealing with the 'Recovery of Arrears of Tax'. The Income Tax Act (7 of 1918), after repealing the Act of 1886, went a step further and consolidated the criminal penalties in a separate Chapter 7, entitled: 'Offences and Penalties'. The subsequent Income Tax Acts, of 1922 and 1961, followed suit and kept the criminal provisions in a separate chapter, though with some changes, and the number of sections has increased. For instance, whereas the Income Tax Act, 1961, has eight sections in Chapter 22 dealing with 'Offences and Prosecution'[15], the

---

12. "Tax Fraud and Evasion", Harry Graham Balter, (3rd ed., 1963), chapters 11.2, 11.3.
13. 'Gunn's Commonwealth Income Tax Law and Practice',(6th ed. 1960), para 3446, p. 1437, paras 3130, 3131, pp. 1417, 1418 for meaning of evasion.
14. Income Tax Act, 1961, chapter 21: 'Penalties Imposable'. Provisions relating to 'Interest' are still scattered all over the Act.
15. Income Tax Act, 1961, Chapter 22 contains 8 Sections, viz 275A 276, 276A, 276B, 277, 278, 279 and 280.

Acts of 1886[16], 1918[17] and 1922[18] had four sections only.

The Indian Income Tax Acts contemplate criminal prosecution for various defaults committed by a person in respect of duties imposed by the Act. These provisions are similar to those in the Income Tax statutes of the United Kingdom[19], the United States of America[20], Australia[21],

---

16. Income Tax Act, 1886, sections 34 to 37.
17. Income Tax Act, 1918, sections 39 to 42.
18. Income Tax Act, 1922, sections 51 to 54.
19. Taxes Management Act, 1970 (1970 c.9), section 107 deals with criminal liability for false statements made to obtain allowances.
20. Internal Revenue Code, 1954, Chapter 75 deals with Crimes, other offences and forfeitures in sections 7201 to 7344. The most important provisions relating to Crimes are dealt with in sections 7201 to 7207; 7201: Attempt to evade or defeat tax, 7202: Wilful failure to collect or pay over tax, 7203: Wilful failure to file return, supply information, or pay tax, 7204: Fraudulent statement or failure to make statement to employees, 7205: Fraudulently withholding exemption certificate or failure to supply information, 7206: Fraud and false statements, 7207: Fraudulent returns, statements, or other documents.
21. Income Tax and Social Services Contribution Assessment Act, 1936-1969, Part VII deals with 'Penal Provisions and Prosecutions' in sections 222 to 251. The following are the main sections dealing with prosecutions:- sections 223: Failure to furnish returns or information, etc., 224: Refusal to give evidence, 227: False returns or statements, 228: Failure to sign or false certificate, 229: False declarations, 230: Understating income, 231: Fraudulent avoidance of tax, 232: Obstructing officers. (See Income Tax Law and Practice (Commonwealth), 2nd edition N.E. Challener and J.M. Greenwood, Australia: Law Book Company, 1962 with 1969 Supplement, p. 1156.

Canada[22] and New Zealand[23], though they differ in scope and weight of the penalties. The offences under the Indian Income Tax Act may be broadly classified into the following categories[24],

(i) failure to make payments or deliver returns or statements or to allow inspection of accounts,

(ii) failure to deduct and pay tax,

(iii) failure to give notice of winding-up of a company in liquidation,

(iv) false statement in declaration,

(v) abetment of false return,

(vi) failure to co-operate in search and seizure, and

(vii) disclosure of confidential information.

---

22. The Income Tax of Canada, 1952, Part VI, which is designed to prevent avoidance or reduction of tax liability, provides for criminal prosecutions under sections 131 (i) for failure to file return, under 131(2), for failure to comply with or contravening provisions relating to withholding of tax by employers, or failure to keep books or records etc., under section 132 for making or participating in the making of a false or deceptive statement in a return or certificate, for evading payment of a tax imposed by the Act, for making false or deceptive entries, or omitted to enter material particulars in record, wilfully evading or attempting to evade tax, and for conspiracy to commit such offences.
23. The Income Tax Assessment Act, (93 of 1957), sections 33 and 34, deal with offences and penalties.
24. '<u>The Indian Income Tax Act, 1922</u>', A.N. Aiyar, S.V. Aiyar and T.A. Rajgopal, 7th edition (1950), pp. 707,708. Four types of offences were provided in the Act of 1922, viz., (i) failure to make payments or deliver returns etc., (ii) false statement in declaration, (iii) disclosure of confidential information, and (iv) failure to give particulars of securities.

The Act has made distinctions between these offences, based on the nature and gravity of the offence in question, providing heavier punsishment for the graver offences. For instance, offences falling under the first category, (i) the punishment provided may extend to ten rupees for every day during which default continues[25], whereas in cases of offences under (ii), (iv) and (v) the punishment may extend to two years rigorous imprisonment[26].

The Income Tax Acts, like other taxing statutes, impose certain obligations on a taxpayer, in order to help the authorities in making proper and just assessments and timely collection of taxes with a view to check and minimize tax evasion and tax avoidance. Omission to discharge such statutory obligation is a penal offence[27]. In other words, if a person fails to perform the duties imposed under the Act, he is liable to prosecution, in addition to other penalties[28]. It may be interesting to discuss the provisions on the point under the various income tax statutes in the following order, viz., the provisions under:

25. Income Tax Act, 1961, section 276.
26. Income Tax Act, 1961, sections 276A, 277, and 278.
27. Similar liabilities accrue in other taxing statutes, viz., The Sea Customs Act, (8 of 1878), section 167, 168; The Indian Stamp Act, (2 of 1899), sections 62 to 72; The Central Excise and Salt Act, (1 of 1944), sections 9, 17, 24 and 27; The Central Sales Tax Act, (64 of 1956), sections 10 and 10A; the Wealth Tax (27 of 1957) section 18 deals with penalty for concealment and S. 36 with prosecution; The Expenditure Tax Act (29 of 1957), sections 17 provides for penalty for concealment and section 32 for prosecution; The Gift Tax Act, (18 of 1958), section 17 deals with penalty for default and concealment and S. 35 with prosecution.
28. See Chapter 6, pp. 317-18, 324-27, 332-35.

(a) The Income Tax Act, 1886,
(b) The Income Tax Act, 1918
(c) The Income Tax Act, 1922, and
(d) The Income Tax Act, 1961.

The Income Tax Act, 1886, provided for the prosecution of a taxpayer who failed to make payments or deliver returns of statements. Sub-section (1) of section 34 of the Act states that:

"If a person fails-
(a) to deduct and pay any tax as required by section 8, sub-section (1)[29] or section 13, sub-section (1)[30], or
(b) to deliver or cause to be delivered to the Collector, in due time the return or statement mentioned in section 10[31] or section 11,[32], or
(c) to produce or cause to be produced, on or before the date mentioned in a notice under section 12[33], such amounts as are referred to in the notice,

---

29. Income Tax Act, 1886, section 8(1) laid down the mode of payment in cases of servants and pensioners of local authorities, i.e., the tax was to be deducted at source.
30. Income Tax Act, 1886, section 13(1) states the mode of payment of tax on interest and on securities; it was to be deducted at source.
31. Income Tax Act, 1886, section 10 provided for the delivery of an annual return to the Collector by the principal officer of the Company or association.
32. Income Tax Act, 1886, section 11, prescribed for the annual statement of net profits made by companies to be submitted to the Collector yearly.
33. Income Tax Act 1886, section 12 gave power to the Collector to require officers of companies to produce accounts, if he had reason to believe that a statement submitted under section 11 was incorrect or incomplete.

((d) to furnish within the specified period a return required of him under section 14-A[34],)[35]
he shall, on conviction before a Magistrate, be punishable with a fine which may extend to ten rupees for every day during which the default continues."

A remarkable feature of the Act of 1886 was that it imposed absolute liability in cases of default under sub-section (1), of section 34 of the Act. A person was liable to be prosecuted for failure to act according to the provisions laid down in the aforesaid sub-section and a reasonable cause or excuse was no defence as it was in the corresponding provisions of the subsequent Acts of 1918[36], 1922[37] and 1961[38]. It was perhaps to avoid hardships caused to taxpayers, that sub-section (2) of section 34 of the Act of 1886, gave power to the Commissioner to mitigate the rigours of the law in genuine dases. Sub-section (2) of section 34 stated:

"The Commissioner of the Division may remit wholly or in part any fine imposed under this section."

It may be noted that the courts, during those days[39], were strict in interpreting such provisions and would not

---

34. Income Tax Act, 1886, section 14-A authorized the Collector to issue notice to persons with income of not less than one thousand rupees to furnish a return.
35. Inserted by the Indian Income Tax (Amendment) Act, (7 of 1917).
36. Income Tax Act, 1918, section 39.
37. Income Tax Act, 1922, section 51.
38. Income Tax Act, 1961, sections 276, 276A, 276B for the present attitude of the Courts.
39. See Chapters 4 and 8 for the present attitude of the Courts.

incorporate the concept of 'reasonable cause or excuse' by implication. This is evident from the two cases decided in the seventies of the nineteenth century.

The first is, The Queen v. Mudhoo Dutt[40] in revision before the High Court under section 438 of the Criminal Procedure Code[41]. The question in issue was whether an appeal would lie to the Sessions Judge from the order of a Magistrate convicting a defaulter under section 25[42] of the Income Tax Act, 1869, because the accused did not pay the tax within the time specified in the notice. While accepting the Magistrate's contention and setting aside the Session Judge's order that an appeal would lie from the Magistrate's order, their Lordships of the Calcutta High Court said:

> "It is my impression that no discretion and no alternative is left to a Magistrate, he must fine the defaulter in twice the amount. He has no power to listen to any plea put forward by a defaulter, provided it is proved that the notice under section 16* was actually served upon the man, and that he neglected to pay the money... Section 24 leaves no alternative to a Magistrate. The defaulter shall, for every day during which the default continues, be fined on conviction before a Magistrate ten rupees."[43]

The next case is Queen v. Chait Ram[44], in which the

---

40. (1884) 14 W.R. 71.Cal. H.C. Though the systematic imposition of taxes begun in India since 1886 by the passing of the Income Tax Act (2 of 1886), it was started as long ago as 1860. See Chapter 2, for 'origin of Income Tax'.
41. The Code of Criminal Procedure (5 of 1890), section 439 deals with the power of revision.
42. See supra, p.341 for the text of the section.
43. (1884) 14 W.R. (Cal.) p.71 at pp. 71,72 (Criminal). The case was decided in 1870.
44. (1870) 2 N.W. p. 113 (High Court).

the High Court of North West Provinces set aside the conviction of the accused for failure to make payment of income tax as required by sections 24 and 25 of the Income Tax Act, 1869, for lack of sanction by Collector[45]: But the Court expressed strong views against violators of statutory provisions. Their Lordships observed as under:

> "By failing to make payment within the time specified in the notice, the taxpayer is guilty of an offence within the terms of Section 25, and subsequent payments does not take the case out of the provisions of that section.[46]

Section 39 of the Income Tax Act, 1918, is the corresponding provision to sub-section (1) of section 34 of the Act of 1886, with some consequential changes. Section 39, which provided for prosecution for failure to make payments or deliver returns or statements or allow inspection states:

> "If a person fails without reasonable cause or excuse-
> (a) to deduct and pay tax as required by section 15[47], or under section 36(2)[48];

45. The Income Tax statutes have since the very beginning provided for sanction by a higher authority for launching prosecution for offences relating to Income tax in order to save the harassment of persons by junior officers. See <u>infra</u> pp. 414-21.
46. <u>(1870)</u> 2 N.W. p.13 (H.C.) at pp. 114, (Head note).
47. Income Tax Act, 1918, section 15 provided for deduction of tax at source.
48. Income Tax Act, 1918, section 36(2) authorized the Collector to require any person paying a salary to deduct from such payment the tax recoverable under sub-section (1) of section 36 for default in making payment.

(b) to deliver or cause to be delivered to the Collector in due time any of the returns mentioned in section 16[49], section 17[50] or section 28[51];

(c) to grant inspection or allow copies to be taken in accordance with the provisions of section 29[52];

(d) to attend or to produce, or cause to be produced, on or before the date mentioned in a notice under section 18,[53] such accounts and documents as are referred to in the notice;

he shall, on conviction before a Magistrate, be punishable with fine, which may extend to ten rupees for every day during which the default continues."

Section 39 of the Act of 1918 differs from the corresponding provision in section 34 of the Act of 1886 in two respects.

---

49. Income Tax Act, 1918, section 16 provided for submission of an annual return by the employer in respect of 'salaries'paid or due to his employees to the Collector within fifteen days from the 31st day of March in each year.
50. Income Tax Act, 1918, section 17 provided for submission of return by the principal officer of every company and the individual assessees to the Collector by June 15, of each year.
51. Income Tax Act, 1918, section 28 gave power to the Collector or Commissioner to call for information.
52. Income Tax Act, 1918, section 29 authorized the Collector or the Commissioner to inspect the register of members of any company and take copies, if necessary.
53. Income Tax Act, 1918, section 18 laid down the procedure for assessment.

Firstly, the Act of 1918 has introduced the phrase 'reasonable cause or excuse'. The result is that a person would not be liable to conviction under section 39 of this Act, if he could prove 'reasonable cause or excuse' for not discharging the obligations imposed under the Act. The phrase appears to have been added to mitigate the hardships caused to taxpayers in genuine cases, because of the strict view of the provisions taken by the Courts in earlier case[54].

Secondly, section 39 of the Act of 1918 is wider in scope than section 34 of the Act of 1886, inasmuch as the former imposes liability in a number of other cases, which were not covered by the earlier Act. For instance, failure to grant inspection or allow copies to be taken of the register of any company as provided under Section 29, was made punishable under clause (c) of section 39 of the Act, which was not so previously.

Section 51 of the Income Tax Act, 1922, is a reproduction of section 39 of the Act of 1918, with some changes. Clause (b) is a new provision, which was not in the Act of 1918. Section 51 of the Act of 1922 states that:

---

54. See The Queen v. Mudheo Dutt (1884) 14 W.R. 71; Queen v. Chait Ram (1870) N.W. 113 supra pp.348-9. As a result of insertion of the phrase 'Reasonable cause or excuse' in section 39 of the Act of 1918, the discretion given to the Commissioner in the earlier Act to mitigate the hardships of law under section 34(2) was withdrawn. See Chapter 2 . pp. 55 to 64 for meaning of 'reasonable cause or excuse'.

"If a person fails without reasonable cause or excuse-

(a) to deduct and pay any tax as required by section 18[55] or under sub-section (5) of section 46[56];

(b) to furnish a certificate required by sub-section (9) of section 18[57] or by section 20[58] to be furnished;

(c) to furnish in due time any of the returns mentioned in section 19A[59], section 20A[60], section 21[61], or

---

55. Income Tax Act, 1922, section 18 laid down the procedure for payment by deduction at source.
56. Income Tax Act, 1922, section 46(5) authorized the Income Tax Officer to require any person paying 'salary' to an assessee to deduct from such payment the arrears of tax and to deposit it to the credit of the Government.
57. Income Tax Act, 1922, section 18 (9) required every person deducting tax to furnish a certificate to the person in question, specifying the amount so deducted and the rate at which the tax has been collected.
58. Income Tax Act, 1922, section 20 required every company to issue certificates to shareholders receiving dividends.
59. Income Tax Act, 1922, section 19A was inserted in 1926. It required the principal officer of a company to furnish a return of the names and addresses of the shareholders who were paid dividends.
60. Income Tax Act, 1922, section 20A was added in 1933. The section required information to be furnished by the person responsible for paying 'interest' other than 'interest on securities' to the Income Tax authorities.
61. Income Tax Act, 1922, section 21 required an employer to furnish a return in respect of salaries paid or due to his employees.

sub-section (2) of section 22[62], or section 38[63];

(d) to produce, or cause to be produced, on or before the date mentioned in any notice under sub-section (4) of section 22[64], such accounts as are referred to in the notice;

(e) to grant inspection or allow copies to be taken in accordance with the provisions of section 39[65],

he shall, on conviction before a Magistrate, be punishable with fine which may extend to ten rupees for every day during which the default continues."

The Income Tax Act, 1961.

The Income Tax Act, 1961, retained the provisions of section 51 of the Income Tax Act of 1922 in section 276 with necessary changes. Section 276 authorizes the prosecution of those who fail to comply with the provisions of the Act without reasonable cause or excuse. Section 276 reads as follows:

---

62. Income Tax Act, 1922, section 22(2) required the Income Tax Officer to serve on every individual, whose total income, in his opinion, renders him liable to income tax, to furnish within a specified period of time a return of his total income.
63. Income Tax Act, 1922, section 38 gave power to the Income Tax Officer or the Assistant Commissioner to call for information for the purpose of this Act.
64. Income Tax Act, 1922, section 22(4) authorized the Income Tax Officer to issue notice to produce accounts, documents, wealth statement or other information as he might think necessary.
65. Income Tax Act, 1922, section 39 authorized the Income Tax authorities to inspect the register of the members of any company, if mecessary.

"If a person fails without reasonable cause or excuse-

(a) to grant inspection or to allow copies to be taken in accordance with the provisions of section 134[66],

(b) to furnish in due time any of the returns or statements mentioned in section 133[67], sub-section (2) of section 139[68], section 206[69], section 285[70], or section 286[71];

(c) to produce, or cause to be produced, on or before the date mentioned in any notice under sub-section (1) of section 142[72], such accounts and documents as are referred to in the notice:

(d) to deduct and pay tax as required (* * * *)[73] under sub-section (2) of section 226[74]or

---

66. Income Tax Act, 1961, section 134 empowers the Income Tax authorities to inspect the register of companies and take copies thereof, if necessary.
67. Income Tax Act, 1961, section 133 gives power to the Income authorities to call for information from a person for the purposes of the Act.
68. Income Tax Act, 1961, section 139(2) states that the Income Tax Officer may serve a notice on an assessee or representative assessee, whose total income renders him liable to income tax, requiring him to furnish a return within thirty days of the service of the notice.
69. Income Tax Act, 1961, section 206 requires the person paying the salary to furnish the prescribed return.
70. Income Tax Act, 1961, section 285 provides that the person responsible for paying interest (other than interest on securities) exceeding Rs. 400 should furnish a return of the names and addresses of all such persons to the Income Tax Officer.
71. Income Tax Act, 1961, section 286 requires information to be given by the Companies to the Income Tax Officer regarding payment of dividends to shareholders.
72. Income Tax Act, 1961, section 142(1) gives power to the Income Tax Officer to issue a notice for the production of such accounts and documents as he may require for the purpose of assessment of tax.
73. The words 'by the provision of Chapter XVII-B or' were omitted by the Finance Act, 1968, with effect from 1st April, 1968.
74. Income Tax Act, 1961, section 226 (2) authorizes the Income Tax Officer to require the person paying the salary to deduct from such payment any arrears due from the assessee.

(e) to furnish a certificate required by section 203[75],

he shall be punishable with fine which may extend to ten rupees for every day during which the default continues."

A cursory examination of the penal provisions for failure to comply with the statutory obligations imposed under section 276 of the Act, would suggest that the Indian Parliament is ignorant of the large scale evasion and avoidance of taxes. No doubt the responsibility for controlling evasion and avoidance lies heavily on the officials of the Income Tax Department. But one can hardly find justification for retaining a punishment 'which may extend to ten rupees a day' for the faults committed under section 276 of the Act of 1961; this punishment was introduced almost a century ago in section 34 of the Income Tax Act of 1886[76], for similar offences, when conditions were altogether different. Perhaps the law makers have failed to appreciate that the deterrent effect of a punishment of ten rupees a day a century ago was greater than today. It would seem that the Legislature in the earlier period was more conscious of the evil consequences of tax evasion and tax avoidance. As Early as 1869, section 25[77] of the Income Tax Act provided for punishment on conviction before a Magistrate to the extent of double the amount of tax due in the case of a person who failed to pay within the period specified in the notice issued under

---

75. Income Tax Act, 1961, section 203 requires the person deducting tax at source to issue a certificate.
76. See supra p.346/7 for text of section 34 of the Act of 1886.
77. See supra p.341 for text of section 25 of the Act of 1869.

section 16 of the Act.

One may argue that the retention of a punishment of Rs. ten a day for such offence is fitting because it is not the amount of fine but the stigma of conviction that matters in such offences. This may be true in regard to offences falling under the general criminal law of the country, but it is not so in the case of offences under the Income Tax Act, the Wealth Tax Act, the Gift Tax and the Sea Customs Act. Convictions for such offences hardly bring any stigma or disgrace on the person involved. As was pointed out by the Lord Ordinary in a Scottish case, Lord Advocate v. A.B., as long ago as 1897, in rejecting the defendant's claim for a jury trial for prosecution under section 52 and 55 of the Income Tax Act, 1842, in respect of neglect to deliver a true and correct statement required under the Act,

> "If I thought that a judgement against the defender would affix upon him a stigma of crime, then I would certainly be in favour of sending the case to a jury; even though the amount involved is small; but I do not take the view that the result of an adverse judgement would be of that nature. I think practically speaking, it may leave the defendant's character uninjured..."[78]

It may be mentioned that the corresponding Income Tax statutes in the United Kingdom, United States of America, Australia, Canada, New Zealand and South Africa provide more severe punishment for offences similar to those consolidated in section 276 of the Indian Income Tax Act, 1961. These

78. (1897) 3 Tax Case 617 reported from 35 Sc. L.R. 190.

provisions are as follows:

United Kingdom

The Taxes Management Act, 1970, in sections 93 and 94[79] provides penalties for failure to make returns of income or capital gains and for corporation tax. Section 93 states that:

> "Section 93.(1) If any person has been required by a notice served... to deliver any return, and he fails to comply with the notice he shall be liable,...
>
> (a) to a penalty not exceeding, except in the case mentioned in sub-section (2) below, £50, and
>
> (b) if the failure continues... to a further penalty not exceeding £10 for each day on which the failure so continues.
>
> (2) If the failure continues after the end of the year of assessment following that during which the notice was served, the penalty under sub-section (1)(a) above shall be an amount not exceeding the aggregate of £50 and the total amount of the tax with which the said person is charged..."

United States of America.

The Internal Revenue Code of 1954, in section 7202 and 7203, provides for prosecution in cases of wilful failure to collect tax as required, to file returns, to supply information, or pay tax to the treasury. The relevant provisions are as follows:

> "Section 7202. Any person required...to collect, account for, and pay over any tax imposed...who wilfully fails to collect or truthfully account for and pay over such tax shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, shall be fined not more than $10,000, or imprisoned for not more than five years, or both, together with the costs of prosecution."
>
> Section 7203. Any person required...to pay any estimated tax or tax, or required... to make a return..., keep any

79. Tax Management Act, 1970, section 94 provides similar penalties as that mentioned in section 93 for failure to make a return for corporation tax.

records, or supply any information, who wilfully fails to pay such estimated tax or tax , make such return, keep such records, or supply such information,... shall, in addition to other penalties provided by law be guilty of a misdemeanor and, upon conviction thereof shall be fined not more than $10,000, or imprisoned not more than 1 year, or both, together with the costs of prosecution."

Australia

The Income Tax and Social Services Contribution Assessment Act, 1936-69, in section 223 and 224,provides penalties for failure to furnish returns or information and refusal to give evidence. Section 223 states:

"223.(1) Any person who fails to duly furnish any return or information or comply with any requirement of the Commissioner as and when required by this Act or the regulations or by the Commissioner shall be guilty of an offence.

Penalty: Not less than four dollars or more than two hundred dollars.

(2) A prosecution for an offence against this section may be commenced at any time."

Similarly section 224 reads as follows:

"Any person who refuses or neglects to duly attend and give evidence when required..., or to truly and fully answer any question put to him by, or to produce any book or paper required of him..., shall, unless just cause or excuse for the refusal or neglect is shown by him, be guilty of an offence.

Penalty: Not less than four dollars or more than two hundred dollars.

Further section 225 provides:

"(1) Upon the conviction...for an offence against either of the last two preceding sections, the Court may order him within a time specified in the order to do the act which he has failed or refused or neglected to do, and any person who does not duly comply with such order shall be guilty of an offence.

Penalty: Not less than twenty dollars or more than one thousand dollars.

Canada

The Income Tax Act, 1952, sections 131(1) and 131(2), authorizes prosecution for failure to file a return or to comply with various other provisions of the Act. Sub-section (1) of section 131 states:

> "Every person who has failed to file a return as and when required... is guilty of an offence and, in addition to any penalty otherwise provided, liable on summary conviction to a fine of not less than $25 for each day of default."

Similarly sub-section (2) of section 131 states:

> "Every person who has failed to comply with or contravened (s. 47(1)-withholding of tax by employers...), (s. 123 (5) - imposes duty to keep withheld tax separate and apart in trust for the Revenue), s. 125 (requires the keeping of books and records) or s.126 (provides for tax investigation and requires non-resistance by investigated persons) is guilty of an offence and, in addition to any penalty otherwise provided, is liable to summary conviction to
>
> (a) a fine of not less than $200 and not exceeding $10,000, or
>
> (b) both the fine described in paragraph (a) and imprisonment for a term not exceeding six months.

New Zealand.

The Land and Income Tax Act, 1954, clause (b) of sub-section (1) of section 33, makes it an offence to use tax money other than in payment to the revenue. The sub-clause states:

> "33(1)... [E]very person commits an offence against the the principal Act, who-
>
> ...
>
> (b) knowingly applies or permits to be applied the amount of any tax deduction or any part thereof for any purpose other than the payment of the tax deduction to the Commissioner;...
>
> ....

(2)... [S]hall be liable to imprisonment for a term not exceeding twelve months or to a fine not exceeding (two hundred dollars) or to both."

South Africa

The Income Tax Act, 1962, section 75, deals with provisions relating to penalties for defaults committed by a taxpayer under the Act. Section 75(i) reads as follows:

"Any person who-

(a) fails or neglects to furnish, file or submit any return or document as and when required under this Act; or

(b) without just cause... refuses or neglects to furnish any information or reply or to attend and give evidence as and when required..., or to answer truly and fully any question put to him, or to produce any book or papers required of him by the Secretary or any such officer; or

(c) fails to show in any return... any portion of the gross income received by or accrued to, or in favour of himself...

(d) fails to show in any return prepared on behalf of any other person any portion of the gross income received by or accrued to or in favour of such other person, or fails to disclose... any facts which, if disclosed might result in increased taxation, or

(e) obstructs or hinders any officer in the discharge of his duties; shall be guilty of an offence and liable on conviction to a fine not exceeding one hundred rand or to imprisonment for a period not exceeding three months or to both such fine and such imprisonment.

It may be observed that not only the Legislature but also the judiciary in these countries has viewed tax crimes(offences) with concern. For instance, in Jackson (Federal Commissioner of Taxation) v. Gromann[80], an

80. (1949) 8 A.T.D. 317.

Australian case on the point, Fullagar, J. advocated the need for a severe deterrent punishment in order to check tax evasion.

The defendant was prosecuted under section 230[81], Part VII of the Commonwealth Income Tax Assessment Act, 1936-43, for knowingly and wilfully omitting to include certain income accrued in the year ending 30th June, 1943, from his return for that year. While rejecting the defendant's plea for the imposition of a moderate penalty on the ground that the maximum penalty under the section was intended for cases of extraordinary gravity, Fullagar, J. said,

> "...[H]eavier the tax the greater the temptation to evade it and therefore the greater need for a severe deterrent."[82]

Under the circumstances, perhaps, it would be more befitting the needs of the time, that the amount of punishment provided under section 276 of the Indian Act of 1961 should be raised at least to the extent provided

---

81. Section 230 which provided provision relating to understatement of income stood at the relevant time as under:
"230.(1) Any person who, or any company...in any return knowingly and wilfully understates the amount of any income or makes any misstatement affecting the liability of any person to tax or the amount of tax shall be guilty of an offence.
Penalty: Not less than Twenty-five pounds, or more than five hunred pounds* and, in addition, the Court may order the person to pay...a sum not exceeding double the amount of tax that would have been avoided if the statement in the return had been accepted as correct.
(Read * Fifty dollars and * One thousand dollars now}.
82. (1949) 8 A.T.D., p. 317 at p. 319 (para 1).

under section 276B[83] of the Act. This would not only act as a deterrent but remove the discrimination caused by the insertion in the Act of 1961, of section 276B[84]. Section 276B provides rigorous imprisonment to the extent of six months and a minimum fine of 15 per cent per annum on the amount of tax from the date on which such tax was deductible to the date on which such tax is actually paid, for failure to deduct and pay tax as provided under sub-section (9) of section 80E[85] or Chapter XVII-B[86], whereas clause (d) of section 276[87] provides a penalty extending to 'ten rupees for every day during which default continues', for failure

---

83. See <u>infra</u> pp263-4 for section 276B.
84. Section 276B was inserted by the Finance Act, 1968, with effect from the 1st April, 1968.
85. Income Tax Act, 1961, Section 80E (which was inserted in 1965 by the Finance Act, 1965) states in sub-section (9) as follows:
"Where any payment by way of annuity or otherwise is made by a person to whom premiums or contributions are payable... such person shall,... deduct from the total amount so paid duting any financial year, tax... and shall pay the amount so deducted to the credit of the Central Government within the prescribed time and in such manner as the Board may direct..."
86. Income Tax Act, 1961, Chapter XVII-B has provisions relating to 'Deduction of Tax at source' in cases of payment of salary (s.192), interest on securities (s.193), dividends (s.194), interest other than 'interest on securities' (s.194A), and any other sums payable to a non-resident (s.195). The person responsible for disbursement of such amounts is to deduct the tax and to pay it to the credit of the Central Government.
87. See <u>supra</u> p.354.

for failure to deduct and pay tax as required by sub-section 226[88] of the Act.

Failure to Deduct and Pay Tax

The Indian Income Tax Statutes have imposed criminal liability since the beginning of tax-legalisation in India[89] on those responsible for disbursing salaries, interest and dividends. For failure to deduct tax before making such payments to the taxpayer and remit the amount of tax so deducted to the credit of the Central Government. However, till 1968[90], the punishment provided for failure to deduct and pay tax was merely 'up to Rs. 10 for every day during which the default continued'. This was considered by the Legislature inadequate to have a deterrent effect on fraudulent taxpayers. Accordingly, section 276 of the Income Tax Act, 1961, was amended in 1968. The provisions relating to punishment for failure to deduct and pay tax, as contained in clause (d) of section 276, starting with the words "by the provision of Chapter XVII-B" or was deleted by the Finance Act, 1968, with effect from the 1st April, 1968, and a new section 276B was inserted in the Act of 1961, which imposes a heavier criminal liability on the defaulting taxpayer as compared with the corresponding earlier provision[91]. Section 276B states:

88. See *supra* note 74.346
89. See Income Tax Act, 1886, section 34(1)(a) *supra* p. 346.
90. Income Tax Act, 1961, Section 276.
91. See *supra* p.354.

> "If a person, without reasonable cause or excuse, fails to deduct or after deducting fails to pay the tax as required by or under the provisions of sub-section (9) of section 80E[92] or Chapter XVII-B[93], he shall be punishable with rigorous imprisonment for a term which may extend to six months, and shall also be liable to fine which shall be not less than a sum calculated at the rate of fifteen per cent per annum on the amount of such tax from the date on which such tax is actually paid."

In 1965 the Indian Income Tax statute imposed criminal liability under section 276A of the Income Tax Act, 1961[94], on a liquidator of a company in liquidation for failure to inform the Income Tax Officer of the assets of the company. This has been done in order to help in checking tax avoidance by companies in liquidation. Sub-section (1) of section 178, of the Act of 1961, requires the liquidator of a company, which is being wound up, either under the orders of a court or otherwise, to inform the Income Tax Officer of the assets of the company within thirty days of his appointment. And sub-section (3) of section 178 places an obligation on the liquidator to set aside the amount of tax before parting with any of the assets of the company, except for paying secured creditors, entitled to have priority over Government[95] dues. If the

---

92. See *supra* n. 85.
93. See *supra* n. 86.
94. Section 276A was inserted by the Finance Act, 1965, with effect from the 1st April, 1965.
95. '*The Law and Practice of Income Tax*', J.B. Kanga, and N.A. Palkhiwala, (6th edition), Vol.I, 1969, p. 870.

liquidator fails to comply with, the said provisions, he renders himself liable for prosecution under section 276A of the Act of 1961, which says:

> "If a person, without reasonable cause or excuse -
>
> (i) fails to give the notice in accordance with sub-section (1) of section 178; or
>
> (ii) fails to set aside the amount as required by sub-section (3) of that section; or
>
> (iii) parts with any assets of the company or the properties in his hands in contravention of the provisions of the aforesaid sub-section,
>
> he shall be punishable with rigorous imprisonment for a term which may extend to two years:
>
> Provided that in the absence of special and adequate reasons to the contrary to be recorded in the judgement of the court, such imprisonment shall not be for less than six months."

It may be appreciated that the Legislature has taken a serious view of a liquidator's failure to inform the Income Tax Officers about the assets of the company under sub-sections (1) and (3) of section 178, of the Act of 1961. For the first time in the history of Income Tax legislation in India, punishment extending to two years rigorous imprisonment with a minimum of six months has been provided for failure to perform the statutory obligation under the Act. This is indeed a healthy sign and the Legislature deserves to be congratulated for taking such a bold step. However, the question remains to be seen how far the Income Tax authorities make use of such penal provisions.

Mens Rea in United Kingdom, Australia, Canada, New Zealand and South African Laws.

A bird's-eye view of the penal provisions for failure to comply with statutory duties imposed by the revenue laws of different countries[96] would reveal that the countries differ as regards the taxpayers criminal liability for such offences.

In the United Kingdom[97], Australia[98], Canada[99], New Zealand[1], and South Africa[2] the tax-payer's liability is absolute in regard to the specific obligations imposed. Words like 'wilfully', 'knowingly', 'intentionally' or 'reasonable cause or excuse' are not found in such provisions. The Courts will neither consider the accused's state of mind when trying such offences, as it normally does in criminal cases, nor will it include the concept of mens rea in the interpretation of the offence by implication. Some cases on the point will be discussed here.

In Attorney General v. Till[3], the respondent was convicted under section 55 of the Income Tax Act, 1842 for delivering an incorrect return of his income in contravention of section 52 of the Act. The relevant portion of section 55 reads as follows:

> "...[I] f any person, who ought by this Act to deliver any list, declaration or statement as aforesaid, shall refuse or neglect so to do within the time limited in such notice,...every such person shall forfeit

---

96. See supra pp. 357-60
97. See supra p. 357.
98. See supra p. 358 .
99. See supra pp. 359.
1. See supra p. 359-60.
2. See supra p. 360.
3. (1910) A.C. 50 (H.L.).

> any sum not exceeding twenty pounds and treble the duty at which such person ought to be charged by virtue of this Act..."

Rejecting the respondent's contention that section 55 applied only to non-delivery of a statement, as distinct from delivery of an untrue and incorrect statement, Lord Gorell said:

> "The frame and object of the sections, which are to compel the necessary disclosure for the purposes of taxation, seem to me to shew that the construction contended for by the respondent is unreasonable.[4]

Their Lordships referred to the Lord Ordinary's (Lord Stormonth Darling) statement in Lord Advocate v. A.B., (35 Sc.L.R. 190, quoted at (1897) 3 T.C. 617, 618), where he says:

> "If a man were to put in a piece of blank paper and call it a statement, or if he were to lodge a statement flagrantly and extravagantly deficient or incorrect, then,-according to the argument of the defender, he would be exempt from prosecution at all events under S.55. The reasonable reading of S.55 is that, if there is a failure to deliver the kind of the statement required by S.52, either by (failure to deliver any) statement at all, or by delivery of a statement which is untrue or incorrect, then the penalty is incurred and may be recovered in the prescribed manner."[5]

In Bales v. General Commissioners of Income Tax for Richford[6], the Chancery Division of the High Court refused

---

4. (1910) A.C. 50, at p. 61.
5. Ibid. In the original report (1897) 3 T.C. 617, at p.618, in place of 'failure to deliver any' statement, the words 'delivering no' have been substituted.
6. (1963-66) 42 Tax cases 17.

to take a lenient view of the accused's failure to make an appeal in time, against the imposition of a penalty for non-appearance as a witness before the Court in response to a summons. A penalty of £25 was imposed on Bales, under the provisions of section 59 of the Income Tax Act, 1952[7], and section 59 of the Finance Act, 1960[8], on 5th March, 1964

---

7. The Income Tax Act, 1952, sedtion 59 dealt with the power of General Commissioners to summon and examine witnesses. The section 59 states:
"The General Commissioners may summon any person whom they think able to give evidence respecting an assessment made or to be made on another person, to appear before them to be examined, and may examine such person on oath...
...
(3) A person who after being duly summoned -
(a) neglects or refuses to appear before the Commissioner at the time and place appointed for that purpose ;
(b) appears, but refuses to be sworn or to subscribe the oath; or
(c) refuses to answer any lawful question touching the matters under consideration
shall forfeit a sum not exceeding twenty pounds."
(section 59(1) was repealed by F.A. 1969 Sch. 21, Pt VII, section 59(3) replaced by Tax Management Act, 1970, section 52 (3).).
8. The Finance Act, 1960, sec. 59 dealt with the power of General or Special Commissioners in relation to appeals and assessments. The relevant provisions were as follows (repealed):
"section 59(1). Any penalty incurred by any person for a failure to comply with a precept under section fifty-four of the Income Tax Act, 1952, or incurred by any person under sub-section (3) of section fifty-nine of that Act...may be awarded summarily by them, notwithstanding that no proceedings for its recovery have been commenced,...
(3) Any penalty awarded by virtue of this section shall for all purposes be treated as if it were tax charged in an assessment and due and payable."
F.A., 1960, section 59(1) to (3) have been incorporated in Tax Management Act, 1970, section 53, and F.A., 1960, sec. 59 (4) in T.M.A., 1970, sec.52 (3).

for failure to appear before the Court. A certificate of award of penalty was sent to Bales and he was informed of his right to appeal to the High Court within 30 days after the award of penalty on 5th March, 1964. The appellant moved the Court on 30th April, 1964, to set aside the penalty award, alleging that the time for appeal should run from the date when the General Commissioner notified him of his right to appeal, i.e., 31st March, 1964, and not from the 5th March, the date when the penalty was awarded.

While rejecting the appellant's contention, Ungoed Thomas, J., said:

> "...There is no requirement in the Acts of Parliament and no requirement in the Rules that the Appellant should be notified of a right of appeal in this case, any more than there is a requirement that an appellant should be notified of a rightnto appeal in the case of any other order made by any court... If time for appeal were extended in this case, then... in every case where notice was not given to an appellant of his right of appeal, the right to appeal should normally be automatically extended from the date at which he was given such notice, despite the absence of any such requirement in any Statute or statutory rule."[9]

In Rex v. Caron[10], the Montreal Court of Sessions went to the extent of making the Director of a company personally responsible for its failure to pay the penalty for non-payment of fine owing to the company being in liquidation. The Labella Aluminium Company, Inc., having been required by the Special War Revenue Act, 1927, section 111(1), to pay Federal taxes to the Treasury, failed to do

9. (1963-66) 42 Tax Cases, 17 at p.22.
10. (1948) 91 Can. Cr. Cases 389.

so for the months of July, August and September, 1945. The Company was condemned to pay a fine of $25 plus costs and a penalty equivalent to the amount of the tax in default i.e., $682,34 or in default suffer distraint. As the company was unable to pay the amount, proceedings were instituted against the Director under section 111(3) of the Special War Revenue Act, 1938, for realization of the sum. The section provided:

> "Where an incorporated company has been convicted of any offence against this Act, every officer, director or agent of the company who has directed, authorized, condoned or participated in the commission of the offence, shall be liable to the like penalties as such company..."[11]

The accused was the President and the real administrator of the Labella Aluminium Company. He co-operated in the formation of a group of enterprises by amalgamating the Company with three other concerns, that would take over all their assets and liabilities. This resulted in huge loss and the Company had to go into liquidation.

The respondent contended that he was not liable for penalty, because he did not have any evil intention in the formation of a group of the companies. The Court rejected the respondent's plea and held him liable under section 111(3) of the Act. Manet, J., speaking through the Court said:

---

11. Ibid. Quoted from pp. 389,390.

"In statutory matters and notably in fiscal law, when the Act creates an offence by reason of any omission whatever (e.g. failure to make a report) such omission in itself constitutes the whole offence, regardless of any question of intent.... The Act being one of public order and its application essential to the proper functioning of the State, for which it constitutes one of the sources of revenue, it must provide that, whether through negligence or bad faith, it is not possible for directors, or other agents of the company named by them, to elude payment of taxes, the levy of which is enacted. Hence, without a provision such as s. 111(3), which prohibits any director or agent of an incorporated company to permit, participate in or simply condone the commission of an offence, no collection would be possible for the Crown or, at the very least, the Crown would lose a substantial part of the revenue that it needs. The object of s.111(3) is...to oblige each director to personally watch and to verify, in case of need, whether all the taxes due under the statute are paid on time by the company."[12]

In R v. Lamothe[13], the Court upheld the Crown's contention regarding remittance of tax deducted from employee's wages. The accused failed to pay to the Receiver General income tax deducted from his employees' pay amounting to $ 468.75 as required by Section 47(1) of

12. Ibid. p.392; A.G. of Canada v. Cossette, (1967), 3 Can. Crim. cas. 100; see Poulin v. Belanger (1961) 132 Can. Crim. cas. 94.

13. (1958), 119 Can. Crim. Cas. 330.

the Income Tax Act, 1952[14]. The accused's plea that he was entitled to set-off the tax payable against the sum of $ 2,000 owed to him by the Receiver-General in respect of his own personal income tax was rejected. It was held that the duty to remit tax under section 47(1) was absolute and unqualified and excluded any question of set-off; in any event there was no question of set-off against the Crown for to permit such a claim would allow a cause of action to be sustained against the Crown without the necessary sanction.

The Courts in Canada, in a series of cases[15], have upheld that a convicting Magistrate has no discretion either to limit the number of days for which the penalty is to be imposed or to reduce the amount of punishment provided under the respective sections of the Income Tax Act .

In Rex v. Thompson Manufacturing Company[16], the defendant company failed to make a return of information

---

14. "Every person paying
    (a) salary or wages or other remuneration to an officer or employee
    ...
    at any time in a taxation year shall deduct or withhold therefrom such amount as may be prescribed and shall ... remit that amount to the Receiver General ... on account of the payer's tax for the year ..."
15. Rex v. Harvison, Rex v. O'Kelly (1924) 3 D.L.R. 312
    Panton v. Spencer (1921) 57 D.L.R. 447
16. (1920) 47 Ontario Law Report 103.

for the year 1918 required to be given under the provisions of section 8[17] of the Income Tax War Tax Act, 1917, within the prescribed period of time. The Court refused to accept the accused's plea for the exercise of judicial discretion in the matter and imposed a penalty of $ 600 for the six days' default of which he was convicted under sub-section(1)of S 9[18] of the Income Tax War Tax Act, 1917. The Court said:

> "No discretion was left to the magistrate to limit the number of days for which the penalty was to be imposed, or to reduce the amount of the penalty below $ 100 for each day's default."[19]

In King v. Smith[20], the Nova Scotia Supreme Court took a similar view. Chisholm J., speaking for the Court said:

> "The magistrate's discretion as to the amount of the fine is not an unrestricted one, it is to be exercised within the limits prescribed in that behalf. If Parliament has fixed the exact penalty, then there are

---

17. Income War Tax Act, 1917, sec.8 authorized the Minister of Finance to require a return containing such information as he thought necessary to be furnished within 30 days, and any officer authorized by the Minister could make such inquiry as he might consider necessary for ascertaining the income of any taxpayer.
18. Income War Tax Act, 1917, (Can) Section 9(1) provided: "For every default in complying with the provisions of the next preceding section, the persons in default shall each be liable on summary conviction to a penalty of twenty-five dollars for each day during which the default continues." Section 131(1) of the present Income Tax Act, 1952 is the corresponding provision of section 9(1) of the Act of 1917. See supra pp. 359. for section 131(1).
19. (1920) 47 Ontario Law Reports 103,104.
20. (1923) 38 Can. Crim. case 327.

> no limits prescribed,... If Parliament meant to limit the penalty and to make the smallest coin the minimum and $ 25 the maximum,one would expect it, to use the phrase so frequently employed in Acts of Parliament, namely, 'a penalty not exceeding $ 25' ".[21]

Similarly, the Ontario High Court held in Queen v. Smith[22], that the offence of failing to file a return under section 131(1) of the Act of 1952, is a continuing one. McRuer, C.J., said:

> "... [T]he offender is liable to prosecution from day to day until he files a return. to hold otherwise would put a construction on the section that would defeat its purpose. Its purpose is to compel persons coming within its scope to file income tax returns. The purpose could not be accomplished if, after conviction, the offender should be immune from prosecution, although continuing to fail to file the income tax return required by the section."[23]

A contrary view is found in Rex v. Bell[24], where the Alberta Supreme Court did not follow the earlier cases on the point and held that the magistrate had a discretion to award a lesser fine than $ 25 for each day's default under sub-section (1) of section 9 of the Income War Tax Act, 1917.

However, the view expressed in Bell's case has not been approved by the Courts in subsequent cases. In R v. Smith[25], the Ontario High Court held that the magistrate does not have jurisdiction to impose a greater or a lesser fine than $25 on a charge showing one day's default under

---

21. Ibid at p.331, 332.
22. (1958) 58 D.T.C. 1125. R.v. Donen (1925), 1, D.L.R. 1141.
23. Ibid. at p. 1127.
24. (1925) 42 Can, Cr. Case 253.
25. (1958) 120 Can. Crim. Case 241.

sub-section (1) of section 131[26] of the Income Tax Act, 1952.

In regard to the amount of evidence necessary under these provisions to establish a case against the accused, the Courts have placed the revenue in a better position than the prosecution in criminal cases for other offences.

In R. v. Tyhurst[27] the respondent was charged under sub-section (1) of section 131 of the Income Tax Act, 1952, for failure to file a tax return, after a demand had been made by the Minister of National Revenue persuant to sub-section (2) of section 44[28] of the Act. It was held that an affidavit made in compliance with section 136(5)[29] of the Act that such demand was sent by registered letter, was prima facie evidence not only of sending such demand but also of the receipt thereof by the taxpayer, and hence the revenue was not obliged to prove, as part of its case,

---

26, See supra p. 359.
27. (1962). Can Crim. Case 89.
28. Income Tax Act (RSC 1952, c148), section 44 (2) states: "...[E]very person shall, on demand by registered letter from the Minister, file, within such reasonable time as may be stipulated in the registered letter, ... a return of the income for the taxation year designated in the letter."
29. Income Tax Act, 1952, Section 136(5)(Can) reads as follows:
"When,... provision is made for sending by mail a request for information, notice of demand, an affidavit of an Officer of the Department setting out that... such a request, notice or demand was sent by registered letter on a named day to the person to whom it was addressed... shall be received as prima facie evidence of the sending and of the request, notice or demand.

(as in criminal cases) that the accused received the letter of demand sent to him.

In South Africa the courts have taken a very strict view of the taxpayer in default and have placed the burden of proof of non-receipt of a demand notice or return on the person denying its receipt.

In R. v. Botha[30], a taxpayer was convicted under sub-section (a) of section 76[31] of the Income Tax Act, 1962, for failure to furnish a return of his income as required under the Act to the local Receiver of Revenue within thirty days of the dispatch of the 'form of return' to him from the Receiver's office. The taxpayer preferred an appeal against his conviction.

Rejecting the taxpayer's claim that he had not received a 'form of return' for completion, the Court held that in the absence of proof by the taxpayer that no 'form of return' was received, the taxpayer should be deemed to have failed to furnish the return and section

---

30. (1960(4) S.A. 6(T); 24 S.A.T.C. 22. See 'Silke On South African Income Tax', A.S. Silke, 5th ed., 1967), p. 850.
31. The Income Tax Act, 1962, (South Africa), Section 76(1)(a) provides as follows:
"A person shall be required to pay in addition to the tax chargeable in respect of his taxable income -

(a) if he makes default in rendering a return in respect of any year of assessment, an amount equal to twice the tax chargeable in respect of his taxable income for the year of assessment.

287[32] of the Criminal Procedure Act, 1955, would apply. The Court approved of the magistrate's decision and observed that the magistrate had been right in assuming that the taxpayer had failed to file a return of his income within the prescribed period of time.

Mens Rea in American Tax Law

In the United States of America, unlike the United Kingdom, Australia, Canada, New Zealand and South Africa, the taxpayer's criminal liability is not absolute. A person will not be held criminally liable for failure to collect[33], or for failure to file return, supply information,, or pay tax[34] unless the failure is'wilful'. In other words, a person would be exonerated from statutory liability to comply with the specific provisions under the Act, if there is an absence of the requisite mens rea necessary to constitute such offences.

It may be noted that, although sections[35] dealing

---

32. The African Criminal Procedure Act (56 of 1955), section 287 states:
"When a person is charged with any offence whereof failure to furnish any information...is an element, he shall be deemed to have failed...to furnish that information unless the contrary is proved."
33. Internal Revenue Code, 1954, section 7202.
34. Internal Revenue Code, 1954, section 7203.
35. Internal Revenue Code, 1954, Chapter 75, deals with crimes, other offences and forfeitures. They are sub-divided into the following sub-chapters:
Sub-chapter A : Crimes: Part I : General Provisions Ss. 7201 to 7215: Penalties 7231 to 7241.
Sub-chapter B: Other Offences Ss. 7261 to 7275.
Sub-chapter C: Forfeitures 7301-7304 and 7321-7329.
Sub-chapter D: Miscellaneous Penalty etc. 7341-7344.

with the criminal provisions prescribe different punishments for different offences, 'wilfulness' is an element common to all crimes[36]. Two important questions in relation to the use of the word 'wilfully', which have diverted the attention of the Courts and which need elucidation, are firstly, its meaning[37], and secondly, its scope, when used in defining of felonies and misdemeanours. However, the courts are not unanimous on the point.

In U.S. v. Palermo[38], the Court had to determine the meaning of 'wilfully' and what amounts to 'wilful failure to pay income taxes in time as required by law'.

The defendant had been convicted, in the District Court for the Eastern District of Pennsylvania, for failing to pay income tax for the calendar years 1953 and 1954 at the required time in violation of section 145 (a)[39] of the Internal Revenue Code, 1939 (for 1953) and section

---

36. 'The Law of Federal Income Taxation', John C. Chommie, University of Miami, (1968), p. 672.
37. In Re City Equitable Fire Insurance Co. (1925) Ch. 407; 434, Romer J., said "...An act, or an omission to do an act, is wilful where the person... knows what he is doing and intends to do what he is doing."
38. 1959, (CA 3), 259 F. (2d) 872, rev'g 157 F. Supp 578.
39. Internal Revenue Code, 1939, section 145(a), was the corresponding provision of section 7203 of I.R.C. 1954. see supra pp. 357-8 for text of section 7203. Section 145 (a) stated as follows:
"...Any person required...to pay any... tax... who wilfully fails to pay such...tax...at the time or times required by law or regulations, shall in addition to other penalties provided by law, be guilty of a misdemeanor..."

7203 of the Internal Revenue Code, 1954[40] (for 1954). It was found as a matter of course that the defendant had been delinquent in payment of taxes from 1947 to 1952 and that he preferred to spend his money on items of luxury rather than pay taxes.

The District Court arrived at the conclusion that the defendant's failure to pay taxes in time "was stubborn, obstinate and perverse;" he acted "without justifiable excuse"; "his conduct was marked by a careless disregard" and"there was a want of justification". And it made the ultimate fact-finding of wilfulness, relying on the meaning laid down in United States v. Murdock[41], where the Court used 'bad purpose' as part of the definition instead of

---

40. See *supra* pp. 357-58 for text of section 7203 of the Act.

41. (1933), 290 U.S. 389. The Court says:
"The word (wilful) often denotes an act which is intentional, or knowing, or voluntary, as distinguished from accidental. But when used in a criminal statute it generally means an act done with a bad purpose... without justifiable excuse... stubbornly, obstinately, perversely... The word is also employed to characterize a thing done without ground for believing it is lawful... or conduct marked by careless disregard whether or not one has the right so to act." (p.394).

'evil motive'.

In appeal the conviction was quashed and the Court of Appeal held that the District Court had applied an improper standard in finding the requisite 'wilfulness', and that there was insufficient evidence of 'wilfulness' to sustain the conviction. The Court stated the proper standard of 'wilfulness' to be applied in such a situation in the following words:

> "Wilfulness is an essential element of the crime prescribed by S. 145(a). It requires existence of a specific wrongful intent - an evil motive - at the time the crime charged was committed; viz., failure to pay the tax due at the time required by law. A series of defaults, indicating a pattern of behaviour, knowingly and intentionally made, may suggest the existence of the specific 'evil motive'. Mere laxity, careless disregard of the duty imposed by law, or even gross negligence, unattended by 'evil motive' are not probative of 'wilfulness'. "42

On the other hand, in U.S. v. Ostendorff[43], the 4th Circuit Court affirmed the lower court's view that 'wilfulness' could be inferred under section 7203 from careless disregard of the statutory provisions. The defendant did not file income tax returns for the years 1959, 1960 and 1961, as required under section 7203 of

---

42. 1959 (C.A. 3), 259F (2d) 872 at p; 882; See U.S. v. Martell 1952 (C.A. 3), 199 F (2d), 670 at p. 672; Bloch v. U.S.1955, (C.A.9.), 221 F (2d) 786; Forster v. U.S. (1956) (C.A.9) 237 F (2d) 617, cf. Imholte v. U.S. (1955), (C.A. 8) 226 F (2d) 585; Wardlow v. U.S. 1955 (C.A. 5), 203 F(2d) 884; Haiger v. U.S. (1949) (C.A. 10), 172 F (2d). p.986.
43. (1967), (C.A.4), 371 F (2d), 729.

the Internal revenue Code, 1954. And the only defence offered by the defendant was that his business required too much time and he had just not been able to get it done. Craven, Circuit Judge, speaking for the Court said:

> "...[T]he jury could permissibly infer that Ostendorff wilfully failed to do what the law requires to be done, i.e., that he had the specific intent to disobey or disregard the requirement of the statute that he file tax returns."[44]

The 9th Circuit Court in Edwards v. U.S.[45] affirmed the trial Court's view that the defence, that the appellant was busy with other matters and simply overlooked his duty to file a return, as required under section 7203, was no answer to a charge of 'wilful failure' to file a return.

In U.S. v. Wilson[46] the U.S. District Court of Delaware refused to hold ignorance of law as an excuse for failure to pay the required tax.

The defendant was charged on information with engaging in receiving wagers and wilfully failing to pay the special wagering occupational tax in violation of sections 4411[47] and 7203 of the Internal Revenue Code, 1954.

It was held that the requirement of 'wilfulness' of a violation was satisfied where the defendant conceded that he had heard of the provisions of the law requiring the

---

44. Ibid. at p. 731.
45. (1967) (C.A.9.), 375 F (2d), 862.
46. (1963)(DC-Del), 214 F. Supp. 629; see U.S. v. Roy, (1962)(DC-Del),213 F. Supp. 479.
47. Internal Revenue Code, 1954, section 4411 states: "There shall be imposed a special tax of $50 per year to be paid by each person who is liable for tax under section 4401 (tax on wager) or who is engaged in receiving wagers for or on behalf of any person so liable."

purchase of the $50 wagering tax stamp prior to engagement in the business, and that he had been violating the law for six months, because deliberate violation of law for a substantial period of time with the intention of getting away with it, is indicative of 'evil motive' necessary to constitute 'wilfulness'.

In Abdul v. United States[48], the Court was called upon to adjudicate on whether there was any difference in the degree of 'wilfulness' required when used in defence of felonies and misdemeanours. Appellant was indicted on twelve felony counts, charging him with wilful failure to truthfully account for and pay over taxes, in violation of section 2707 (a)[49] of Internal Revenue Code, 1939, and six misdemeanour counts charging him with wilful failure to file tax returns at the time required by law, in violation of section 2707(b)[50] of the Internal Revenue Code, 1939.

The U.S. District Court for the District of Hawaii acquitted the accused on the felony charges but convicted on the misdemeanours, on the ground that he knew that he was required to submit a return in time, but nevertheless failed to file it. This fact was held sufficient to convict the appellant for misdemeanour, because the two charges required different degrees of wilfulness. The trial judge instructed the jury as follows:

---

48. 1958, (C.A.9), 254 F (2d), 292.
49. See supra p. 357 for section 7202 of Internal Revenue Code, 1954, which is the corresponding provision to section 2707 (c) of I.R.C., 1939.
50. See supra pp.357/8 for section 7203 of I.R.C., 1954, the corresponding provision to section 2707 (b) of I.R.C.1939.

"...The word 'wilful' as used in (the misdemeanour) counts..., that is, failing to make a tax return, means with a bad purpose or without grounds for believing that one's act is lawful or without reasonable cause, or capriciously, or with a careless disregard whether one has the right so to act. The word 'wilful' as used in the (felony) counts... that is, in failing to truthfully account for and pay over the taxes, means with knowledge of one's obligation to pay the taxes due and with intent to defraud the Government of that tax by any affirmative conduct."[51]

Accordingly, the trial Court held, that the accused's defence that he believed that he could not file a return unless he paid the taxes at the same time and that, since he did not have the money, he did not file the return at the required time, was no excuse to the offence of misdemeanour. The Circuit Court approved of the Trial Court's view of wilfulness on the point, though the decision was reversed on the ground of error in cross examination being prejudicial to the defendant. Orr, Circuit Judge, speaking for the Court said:

"...[T]he word 'wilful', as used in the misdemeanour statute, means something less when applied to a failure to make a return than as applied to a felony non-payment of tax..."[52]

The Court quoted the following passage from Spies v. United States in support of its view-

---

51. 1958, (C.A.9), 254 F(2d) 292 at p. 294.
52. Ibid at p. 294 (para 3) U.S. v. Di Silvestro, (1957), 147 F. Suppl. 300. The District Court made a similar remark in regard to the evidence required for conviction in case of misdemeanour offences. The Court says: "...[T]he present 'lesser offence' of a misdemeanour requires a showing considerably less positive than required for a conviction under the felony statute..." At. P.304 (paras 4-5 see Yarborough v. U.S. (1956), (4 Cir.), 230 F. 2(d) at pp. 60,61.

"The difference between wilful failure to pay a tax when due, which is made a misdemeanour, and wilful attempt to defeat and evade one, which is made a felony, is not easy to detect or define. Both must be wilful, and wilful, as we have said, is a word of many meanings, its construction often being influenced by its context: U.S. v. Murdock, 290 U.S. 389 . It may mean something more as applied to non-payment of a tax, than when applied to failure to make a return. Mere voluntary and purposeful, as distinguished from accidental, omission to make a timely return might meet the test of wilfulness."[53]

In the recent case Edwards v. U.S.[54], it was held that a different degree of 'wilfulness' is required for conviction for wilful failure to make a return under section 7203[55], from that required for a conviction for making a false return under section 7206(2)[56] and for wilful attempt to evade or defeat tax under section 7201[57] of the Internal

---

53. (1943), 317 U.S. 492, at pp. 497,498.
54. 1967 (CA.9), 375 F (2D), 862.
55. See supra p.357-58 for section 7203.
56. Internal Revenue Code, 1954, section 7206 (2) states:
"Any person who-
....
(2) Wilfully aids or assists in or procures, counsels, or advises the preparation or presentation of a return, affidavit, claim, or other document, which is fraudulent or is false as to any material matter, whether or not such falsity or fraud is with the knowledge or consent of the person authorized or required to present such return, affidavit, claim or document;
....
shall be guilty of a felony and, upon conviction thereof, shall be fined not more than $ 5,000 or imprisoned not more than 3 years, or both, together with the costs of prosecution."
57. Internal Revenue Code, 1954, section 7201 states:
"Any person who wilfully attempts in any manner to evade or defeat any tax... shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, shall be fined not more than $ 10,000, or imprisoned not more than 5 years, or both , together with the costs of prosecution."

Revenue Act, 1954.

The defendant was convicted in the U.S. District Court for the District of Oregon of Income Tax violations arising out of (i) failure to file income tax returns for the years 1959, 1960 and 1961 as required under section 7203, (ii) for making false returns for certain named clients under section 7206 (2) and (iii) for attempting to defeat or evade tax under section 7203. With regard to the first charge, the Court affirmed the trial Court's holding that the defence that the appellant was busy with other matters and simply overlooked the need to file a return, did not relieve him of the statutory liability under section 7203. It held that the appellant's omission to meet the statutory requirements would satisfy the test of 'wilfulness' under the section.

The facts with regard to the second charge in brief are that the appellant, a tax attorney, prepared statements of estimated tax due and collected from his clients the amounts payable, representing that the statements would be filed and the payments would be made, but he failed to file the statement or pay the tax. At the time when the final returns were prepared, he falsely showed the estimated tax payments as having been made and as being proper credits against the total tax due. The clients signed the returns so prepared on the appellant's representations and the returns were filed. It was found that it was the practice of the appellant to secure from his clients a cheque payable to him, covering the amount of tax due and his fee, and to deposit the amount in a 'special trust' account on which he drew cheques in favour of the Collector of Inland Revenue against his clients' tax charges. In fact, the appellant's purpose was to take advantage of the time lag in Government investigation of delinquent returns to tide him over a period of financial hardship.

The Court made a distinction with regard to the degree of 'wilfulness', i.e., evil state of mind required for conviction of the felony of fraud and false statement and attempt to evade or defeat tax under sections 7206 and 7201; the accused was convicted of the former and acquitted of the latter on the same facts. With regard to the appellant's contention that the record did not establish that his motive was sufficiently evil for conviction under section 7206, the Court said:

> "The offence to which this section (7206) is directed is not evasion or defeat of tax. Rather it is falsification and the counselling and procuring of such deception as to any material matter. Here the falsification was committed deliberately, with full understanding of its materiality; with intent that it be accepted as true and that the appellant thereby gain the end he sought. This, in our judgement, is sufficient to constitute 'wilfulness' under this section."[58]

---

58. 1967 (C.A.9) 375 F(2d), 862, at p. 865.

As regards the charge of attempt to evade or defeat the tax or its payment under section 7201, it was held that a specific intent to do so was necessary to satisfy the test of 'wilfulness' under the section. The Courts said:

> "...Evasion and defeat,... contemplate an escape from tax and not merely a postponement of disclosure or payment. A knowing and intentional omission to file could be the result of either purpose, and either purpose might support a prosecution for the state crime of embezzlement or other forms of theft. Tax evasion, however, focuses on the accused's intent to deprive the Government of its tax moneys, and this requires more than just delay."[59]

On the other hand the 5th Circuit Court in Haner v. United States[60], disapproved of the 9th Circuit Court's view in Abdul v. United States[61], in which similar charges of wilful failure to file an income tax return at the appropriate time, in violation of section 7203 of the Internal Revenue Code, 1954, was made. The Court refuted the Government's claim that the word 'wilful' meant something less when used in a statutory misdemeanour than when used in a felony and held that the same standard of proof is needed, irrespective of its use in any context. Hutcheson, Circuit Judge, delivering the majority judgement, said:

> "...Wilful' generally means intentional, knowing, or purposeful, as opposed to careless, thoughtless, heedless, or inadvertent, and it means nothing less as used in section 7203."[62]

---

59. Ibid at p. 867. See 'Collateral Estoppel Applied to Civil Fraud Penalty', Buchwald, (1965) 719 U. Miami, L. Rev. 672 at p. 674.
60. 1963 (C.A.5), 315 F. (2d) 792. However, Wisdom, Circuit Judge dissented from the majority view and upheld trial Court's upholdings.
61. 1958, (C.A.9), 254 F (2d) 292.
62. 1963 (C.A.5) 315 F. (2d), 792, at p.794 (para 2).

Similarly in the United States v. McGonigal[63], where the defendant was charged with wilful failure to pay the special wagering or occupational tax, as required under section 4411[64] and 7203 of the Internal Revenue Code, 1954, the District Court of Delaware, demanded a greater degree of proof for conviction. Layton, District judge, said:

> "In order for the jury to return a verdict of guilty, it must find, not only that the defendant was engaged in the business of a writer but that his failure to purchase a $ 50 gambling tax stamp was wilful. In order for a criminal act to be wilful, it must not only be committed deliberately and knowingly, but with a bad motive or evil intent."[65]

The Court further noted that the Government had to produce satisfactory evidence to establish beyond reasonable doubt that the defendant deliberately committed the specific offence with the intention of getting away with it. In other words, the revenue has to discharge the same heavy burden for a misdemeanour as is required in the case of a felony.

Mens Rea in Indian Tax Law

In India the legislature has adopted a middle course, i.e., an approach midway between that followed in the United Kingdom, Australia, Canada, New Zealand and South Africa on the one hand and the United States of America on the other, in regard to a person's criminal liability for failure to

---

63. 1963 (DC-Del), 214 F. Suppl. 621.
64. See supra note 47 for section 4411.
65. 1963 (DC-Del), 214 F. Suppl. 621 at p. 622 (para 1).

perform statutory duties imposed under the provisions of the Income Tax Act. Neither is absolute liability imposed nor is a search made for the accused's evil state of mind. A person can plead 'reasonable cause or excuse' as a defence to a charge of failure to discharge statutory obligations[66].

The question that arises in this connection is what is the meaning of the words 'reasonable cause or excuse'. It may be noted that, though this defence has been available to a person since 1918[67](as contained in section 39 of the Income Tax Act, 1918); there is hardly any case in which 'reasonable cause or excuse' has been pleaded in defence to a criminal charge of failure to comply with statutory obligations.

In the solitary case, Bai Lalita Ratanchand Khimchand v. Tata Iron and Steel Co. Ltd.[68], the question came before the Bombay High Court as a collateral issue. The respondent company paid dividends to the appellants, the second preference shareholders, after deducting income tax for the years 1926-27 to 1935-36, and issued no certificate of

---

66. Income Tax Act, 1961, Ss. 275A,276, 276A and 276B. See for 'reasonable cause or excuse' *supra* pp.354,364-65,411. It has also been recognized as defence under Ss. 270, 271 (i)(a), 271(i)(b), 273(1)(b) and 273(1)(c). See Chapter 6, pp.325,317-18,327 respectively.
67. See *supra* pp.349-50 for text of section 39 of the Act of 1918.
68. (1940) 8 I.T.R. 337 (Bom.);A.I.R. 1940 Bom. 97.

deduction as provided under section 20[69] of the Income Tax Act, 1922. The company did not pay any income tax to the revenue authorities as its profits were wiped out by the depreciation allowance and arrears thereof under the provisions of section 10(2)(vi)[70] of the Act of 1922.

The appellants brought a suit against the company to recover dividends, without any deduction in respect of income tax, as no tax was paid by the company. The Court upheld the appellant's claim. As regards the plea that the provisions under section 20 are mandatory and attract prosecution under section 51 of the Act of 1922, for failure to issue a certificate, Beaumont, C.J, said:

> "The provisions of section 20 are no doubt mandatory, but, ... they only apply where the company is liable to tax, and I cannot think that the officers of the company in this case were justified, as against their preference shareholders, in giving year after year a certificate that income tax had been or would be paid on the profits being distributed when in fact no income tax was being charged on such profits. The penalty imposed by Section 51 on a failure to furnish a certificate under Section 20 only arises where the failure is without reasonable cause, or excuse and the fact that the certificate would be untrue would seem to provide reasonable cause for not issuing it."[71]

---

69. See <u>supra</u> p. 352 for section 20.
70. Income Tax Act, 1922, section 10(2)(vi) dealt with the depreciation allowances available to an assessee which could be deducted in computing 'profits and gains' for the purposes of assessment of tax. Income Tax Act, 1961, section 32(1)(i), (ii) & (iv) is the corresponding provision to section 10(2)(vi) of the Income Tax Act, 1922.
71. (1948) 8 I.T.R. 337, at p. 345 Bom. (F.B.).

In the usual sense of the term 'reasonable cause or excuse' means such a cause as would prompt a man of ordinary intelligence to act under similar circumstances as did the taxpayer in failing to comply with his statutory obligations.[72] In brief it may be summarized on the lines of the test applicable in the law of tort as follows:

> "If the taxpayer exercised ordinary care and prudence and was nevertheless unable to file the return in the prescribed time, then the delay is due to reasonable cause."[73]

The question whether the circumstances justify the defence of 'reasonable cause' in a particular case is entirely a question of fact[74].

A somewhat similar defence is available under section 146[75] of the Act of 1961 to a taxpayer for cancellation of a 'best judgment assessment' made under section 144[76]. Section 146, as stated earlier, provides for cancellation, if there is 'sufficient cause' for non-compliance with the statutory requirements under the section. And the courts have interpreted the question of sufficiency or non-sufficiency of facts to justify 'sufficient cause' as an issue of fact[77].

---

72. '<u>The Law of Federal Income Tax</u>', Randolph E. Paul and Jacob, Marten, Vol.V,(1934), s. 4815, at p. 427.
73. <u>Ibid</u>., see'<u>Fraud and the Federal Income Tax in the United States</u>', Harold M. Groves and Arthur M. Selle (1953), 7 Bulletin for International Fiscal Documentation 321 at p.323
74. <u>Orient Investment and Finance Co</u>. v. <u>Commissioner</u>,*166 F (2d) 601, 604 (1948).
75. See Chapter 2, p. 52 for section 146.
76. See Chapter 2, pp.51-52 for section 144.
77. See Chapter 2, pp.65-67.

A case decided by the U.S. Court of Claims, Handley Motor Company, Inc. v. United States[78], appears to be relevant here to show when the defence can be sustained. The Commissioner of Inland Revenue assessed a penalty, pursuant to the provisions of section 6651[79] of the Internal Revenue Code, 1954, because of the appellant's failure to file an excise tax return with respect to the sale of a certain authomobile from Germany.

The question was whether the plaintiff's failure to file the return was due to 'reasonable cause and not due to wilful neglect'. The Court, rejecting the plaintiff's defence that he had filed no return, because he believed in good faith, that no tax was due, said:

> "... [T]he plaintiff has not shown by a preponderance of the evidence that it exercised ordinary business care and prudence in connection with its failure to file an excise tax return. Mere uninformed and unsupported belief by a taxpayer, no matter how sincere that belief might be, that he is not required to file a tax return, is insufficient to constitute reasonable cause for his failure so to file... The term 'reasonable cause' in section 6651 has been interpreted to mean no more than the exercise of ordinary business care and prudence."[80]

---

78. (1965), 338 F (2d), 361.
79. Internal Revenue Code, 1954, 6651 states:

    "In case of failure to file any return required ... on the date prescribed therefor ..., unless it is shown that such failure is due to reasonable cause and not due to wilful neglect, there shall be added ... 5 per cent of the amount of such tax if the failure is for not more than one month, with an additional 5 per cent for each additional month or fraction thereof during which such failure continues, not exceeding 25 per cent in aggragate.".
80. (1965), 338 F (2d), 361 at p. 365: Fisk v. Commissioner (1953), 203 F (2d), 358 (6 Cir.).

And the burden of proof is on the taxpayer to prove reasonable cause for failure to comply with the statutory obligations under the Act[81].

False Statement in a Declaration.

Success in administering the Income Tax Act, like other fiscal statutes depends on the honesty and co-operation of a taxpayer in making a true and correct statement of income, disclosing all material facts[82] and information, as required under the provisions of the Act, to the Income Tax authorities. This is necessary for determining the true tax liability. As stated by Das Gupta, J., in Calcutta Discount Company Ltd. v. Income Tax Officer, while delivering the majority judgement of the Supreme Court,

> "... In every assessment proceedings, the assessing authority will, for the purpose of computing or determining the proper tax due from an assessee, require to know all the facts which help him in coming to the correct conclusion."[83]

---

81. In the United States the burden of proof is on the taxpayer in the case of defence of 'reasonable cause' for exemption from civil liability. Breland v. U.S., 303 F(2d), 492, 497 (5th Cir. 1963). See for 'burden of proof', infra , Chapter 8,pp.
82. C.I.T., Gujarat v. Raman and Company, A.I.R. 1968 S.C. 49; Calcutta Discount Co. Ltd.v. I.T.O. A.I R.1961 SC 372,376. P.R. Mukherjee v. C.I.T., W.B., A.I.R., 1956 Cal. 197. Rameswar Goenka v. I.T.O., Shillong, A.I.R. 1970 A and N. 85 at p. 89. (para 16); Madhya Pradesh Industries Ltd. v. I.T.O., Nagpur, A.I.R. 1970, S.C. 1011; S. Narayanappa v. C.I.T., Bangalore, A.I.R. 1967 S.C. 523; Kantamami and Sons v. 1st Additional I.T.O. Rajahmundry, A.I.R. 1967 S.C. 587.
83. A.I.R. 1961 S.C. 372 at p. 376 (para 8).

However, compliance with the provisions can only be ensured by a threat of punishment for failure. Accordingly, the Indian Income Tax Act, like the corresponding statutes of the United Kingdom[84], United States[85], Canada[86], Australia[87] and New Zealand[88], provides a fine and imprisonment for wilfully furnishing false and inaccurate statements in returns, and concealing facts[89].

Like other penal provisions, the scope of the provisions providing punishment for making false statements in returns and in declarations has been extended from time to time. For instance, the Income Tax Act, 1886, provided for prosecution under section 35 in one situation only, i.e., where a person required to submit a return of his income in

---

84. Taxes Management Act, 1970, sections 95 and 96 provide penalty for furnishing incorrect returns or accounts for income tax or capital gains tax and corporation tax respectively.
85. Internal Revenue Code, 1954, section 7204 provides prosecution in the case of a fraudulent statement or failure to make a statement to employees, section 7206 for fraud and false statement and 7207 for fraudulent returns, statements or other documents.
86. Income Tax Act (RSC, 1952, c 148), section 132(1)(a).
87. Income Tax and Social Service Contribution Act, 1936-1969, sections 227, 228, 229, 230 and 231 have provisions relating to prosecution in cases of false returns or statements, failure to sign or false certificate, false declarations, understating income and fraudulent avoidance of tax respectively.
88. The Land and Income Tax Act (1954), section 33 provides for prosecution.
89. Sivagomintha Moopnar and Sons v. I.T.O., Madurai, (1953) 28 I.T.R. 601.

pursuance of a notice issued under sub-section (1) of section 14A[90], furnished a false declaration that the estimate of income was correct, whereas, the Income Tax Act, 1961, in section 277[91] made every case of false verification punishable under the Act. The relevant provisions are as discussed below.

The Income Tax Act, 1886, section 35, which dealt with a false statement in a declaration provided:

> "If a person makes a statement in a declaration under sub-section 14-A, sub-section (2)[92], which is false, and which he either knows or believes to be false or does not believe to be true, he shall be deemed to have committed the offence described in section 177[93] of the Indian Penal Code."

The Income Tax Act, 1918, in addition to re-enacting the provisions of section 35 of the Act of 1886 in section

---

90. Income Tax Act, 1886, section 14A was added by the Indian Income Tax (Amendment) Act, (7 of 1917). It authorized the Collector to issue a notice to persons with income of not less than one thousand rupees to submit a return of their income.
91. See infra p. 399.
92. Income Tax Act, 1886, section 14A (2) stated: "A person making a return ... shall add at the foot thereof a declaration that the income shown in the return is truly estimated on each of the sources mentioned,..."
93. Indian Penal Code, (45 of 1860), provides punishment of a person, who being legally bound to furnish information to a public servant, furnishes as true, information he knows or has reason to believe to be false.

40[94], provided for the prosecution in two other cases, viz., where the principal officer of a company required to submit a return of total income of the company under sub-section (1) of section 17[95], and a person presenting a petition against assessment under section 21[96] makes false statements in the verifications. The Act of 1918, is remarkable in that it made a significant change in the arena of criminal prosecution for tax crimes, when the Officers of a company were made vicariously

---

94. Income Tax Act, 1918, section 40 provided that:

 "If a person makes a statement in a verification mentioned in section 17 or section 21(3) which is false, and which he either knows or believes to be false or does not believe to be true, he shall be deemed to have committed the offence described in section 177 of the Indian Penal Code."

95. Income Tax Act, 1918, section 17 (1) provided:

 "The principal officer of every company shall prepare, and, on or before the fifteenth day of June in each year, deliver or cause to be delivered to the Collector a return in the prescribed form and verified in the prescribed manner of the total income of the company during the previous year".

96. Income Tax Act, 1918, section 21(1) gave power to an assessee to present a petition to the Commissioner for relief against any order of the Collector in respect of assessment or adjustment under the Act.

liable[97] for making false verification in returns submitted on behalf of a company.

Section 52 of the Income Tax Act, 1922, which corresponds to section 40 of the Act of 1918, and section 35 of the Act of 1886, introduced punishment in a number of other cases of false statement made in verifications contemplated by different sections in the Act. For instance, section 52 provided:

> "If a person makes a statement in verification mentioned in section 19A[98] or section 20A[99] or section

---

97. As a general principle of law a person is subject to assessment and payment of tax in respect of his own income. But in certain circumstances a person is made answerable in respect of assessment and payment of tax of another person as well, by virtue of the provisions of the Act, and he is deemed to be the assessee in law. The Income Tax Act, 1961, has made such provisions in sections 159 (legal representative), 160 to 167 (representative assessees) 170 succession to business or profession), 171(6) (former members of a Hindu undivided family which was partitioned), 177 (members of an association dissolved or discontinued), 178(4) (liquidators of a company) and 179 (directors of a private company in liquidation. See '<u>Vicarious Liabilities under the Income Tax Act, 1961</u>', V.B. Haribhakti, Tax Consultants Association Souvenir (1964), Jaipur; <u>Kapurchand Shrimal</u> v. <u>Tax Recovery Officer</u>, A.I.R. 1969 S.C. 682.pp. 93-110.
98. Income Tax Act, 1922, section 19A dealt with supplying information regarding dividends.
99. Income Tax Act, 1922, section 20A, dealt with supplying information regarding interest.

21[1] or section 22[2] or sub-section (2) of section 26A[3] or sub-section (3) of section 30[4] or sub-section (3) of section 33[5], which is false, and which he either knows or believes to be false, or does not believe to be true, he shall be punishable, on conviction before a Magistrate, with simple imprisonment which may extend to six months, or with fine which may extend to one thousand rupees, or with both.

The basic feature of section 52 of the Act of 1922 was similar to the corresponding provisions in the earlier Acts, but in 1939[6] it was amended by the Act 7 of 1939, so that instead of the reference to section 177 of the Indian Penal Code, the section was self-contained and itself provided the punishment for the offence of making a false return.

Section 277 of the Income Tax Act, 1961, unlike the corresponding provisons of the previous Acts specifying sections or catena of sections under which prosecutions could be launched for false declarations, made the penal

---

1. Income Tax Act, 1922, section 21, required an employer to furnish a return in respect of 'salaries' paid or due to his employees.
2. Income Tax Act, 1922, section 22, provided provisions relating to furnishing a return of income to the Income Tax Officer of the local jurisdiction.
3. Income Tax Act, 1922, section 26A, provided procedure for registration of firms.
4. Income Tax Act, 1922, section 30(3) laid down the procedure for appeal against assessment.
5. Income Tax Act, 1922, section 33(3), provided for appeal against the order of the Appellate Assistant Commissioner.
6. 'The Law of Income Tax in India', V.S. Sundaram, 7th edition, 1954, p. 1086; The Indian Income Tax Act, 1922, A.N. Aiyar, S.V. Aiyar and T.A. Rajgopal, 7th ed., The Company Law Institute of India, Madras (1950), p.708.

provisions applicable to every case of false verification and of furnishing inaccurate particulars of income. The impugned section differs from the earlier provision in respect of punishment as well. For instance, section 277 provides for rigorous imprisonment up to two years with a minimum of six months, whereas in the earlier corresponding provisions punishment was limited to simple imprisonment up to six months, or a fine up to Rs. 1,000 or with both. The section reads as follows:

> "If a person makes a statement in any verification under this Act or under any rule made thereunder, or delivers an account or statement which is false, and which he either knows or believes to be false, or does not believe to be true, he shall be punishable with rigorous imprisonment for a term which may extend to two years:
> Provided that, in the absence of special and adequate reasons to the contrary to be recorded in the judgement of the court, such imprisonment shall not be less than six months."[7]

To support a prosecution for making a false statement in a declaration, two conditions must be satisfied, viz., that the statement must be false, and that the person making it should either know, or believe it to be false, or does not believe it to be true[8]. This raises the question what does 'false' mean, what is the requisite degree of mens rea and what is the standard of proof required for a

---

7. The words 'punishable with rigorous imprisonment... not less than six months', were substituted for the words 'punishable with simple imprisonment which may extend to six months, or with fine which may extend to one thousand rupees, or with both', by the Finance Act, 1964, with effect from the 1st April, 1964.
8. Supra note 6, at p. 1086.

conviction. As stated earlier, there is a dearth of cases on the point owing to a very limited number of prosecutions for tax crimes in India. However, some idea can be formed about the judicial trend from the few cases available on the subject.

An examination of the meaning of the word 'false', as used in the section, reveals that the courts have adopted a dictionary meaning of the term, as implying something designedly untrue, and deceitful, as meaning something more than mere untruth[9]. In other words, the section would apply only to cases of wilful falsification of statements and not to cases of genuine mistakes, misunderstanding, inadvertance or carelessness[10].

A person will also not be liable under the section for making a false return, if he expressly states that the return is incomplete[11]. The fact that the return was false, that the defendant knew that it was false, and intended to evade his tax liability is normally inferred from the nature

---

9. Chambers' Twentieth Century Dictionary, (1968), p. 384, (Col.1); see Regina v. Regerr, (1967) 3 Can. Cr. Case 68, at p. 75 for meaning of the term 'false'.
10. Supra note 6, at p. 1086. The position is similar in the United States of America. As stated by Harry Graham Balter in his book 'Tax Fraud and Evasion: A Guide to Civil and Criminal Principles and Practices Under Federal Law, 3rd ed., (1963), sec. 2.9, "The false act by itself is not fraud unless a fraudulent state of mind accompanies it; so the failure to pay the tax legally due, or the filing of a false return, is not enough, the evil state of mind which must accompany the act may be variously referred to as (1) bad faith, (2) intent to evade tax, (3) wilfulness, etc."
11. Champalal Girdharilal v. Emperor, A.I.R. 1933, Nag. 358 at 359.

of the understatement[12], the assessee's experience in tax and business affairs[13], his signature on the return[14] and other relevant facts connected therewith[15]. Some of the cases that throw light on the subject are mentioned below.

In Ganga Sagar v. Emperor[16], the Allahabad High Court held that the necessary *mens rea* could be inferred from the circumstances of the case. The appellant was convicted of making false and deceptive statements in his tax return for the taxation year 1926-27, under section 177, Indian Penal Code, 1860, read with section 52 of the Income Tax Act, 1922, and sentenced to pay a fine of Rs. 1000.

---

12. Ganga Sagar v. Emperor, A.I.R. 1929 All 919; In Sivaro v. U.S., (1967)(C.A.1.), 377 F (2d), 469, it was held that a tax return that omits material items necessary to the computation of income is not 'true and correct' within section 7206(a) of the I.R.C., 1954. In other words, it amounts to furnishing false tax returns and so the accused was liable under section 7206(a) for perjury; In Cooper v. U.S., 233 F (2d) 821 (8th Cir. 1956) it was held that the constant failure to report substantial sums of income was a strong and adequate evidence of fraud.
13. P.D. Patel v. Emperor, A.I.R. 1933 Rang. 292; Inspecting Assistant Commissioner of Income Tax v. Chotabhai Javerbhai, A.I.R. 1941 Mad. 941.
14. K.C.V. Reddy v. Emperor, A.I.R. 1930 Rang.201. The accused, who was prosecuted for making a false verification in return, contended that he signed it without looking at the figures and so he did not have the requisite degree of *mens rea* for conviction. The information which he furnished showed that the business was running at a loss, whereas it was running at a profit. It was held that the accused was liable. Baguley J., said: "... A man who signs a document which is false and which he does not believe to be true is as liable as though he had made a deliberately false statement. This, when he is bound by law to say the truth." (At p.207 (para 3).
15. 'Penalties and Prosecutions for Evasion of the Federal Income Tax', Gerald L. Wallace (1946), 1 Tax Law Rev. 329 at p. 335.
16. A.I.R. 1929 All 919.

The facts of the case are interesting and reveal how shrewd the taxpayer was. The appellant was a wealthy trader. He had numerous shares in a number of companies, paying handsome dividends each year. The Income Tax Officer issued a notice to the appellant under section 22(2) of the Act on April 2, 1927, to make a return of his income for the year 1926-27 by the 15th day of May, 1927. The appellant did not take any notice of it. It was only on 25th July, that the appellant appeared before the Income Tax Officer with his account books, which he placed before him and asked him to examine the records. Though it was none of the business of the Income Tax Officer, he examined the nakal bahi (account book) in which receipts of dividends had been shown. On a cursory examination of the records the Income Tax Officer calculated the income at Rs. 62,000. The appellant then hurriedly prepared a statement entering the amount noted by the Income Tax Officer as his dividends.

The unusual way in which the appellant behaved made the Income Tax Officer suspicious about his real income from dividends. He accordingly made inquiries about the appellant's income from different sources and came to the conclusion that the appellant had not disclosed a large sum of money (approximately Rs. three lakhs) received as dividends. The Income Tax Officer, therefore, started preliminary proceedings to recover the amount of tax. At this stage, afraid of being criminally prosecuted, the appellant submitted a revised return on November 7, 1927, including the whole amount received as dividends.

It was held that the accused was liable for making a false statement in a return under section 52 of the Act. The Court rightly observed that the fact that the appellant made a revised and correct statement might go in mitigation of sentence but the offence once committed could not be erased by such rectification[17]. It was further held that the section imposed a legal obligation to disclose every fact within one's knowledge and its suppression amounted to the commission of an offence under the impugned section.

In Hazari Lal v. Emperor[18], the appellant submitted a return of his income, duly verified, showing an income of Rs. 896. The Income Tax Officer did not accept it as correct and examined the records and evidence produced by the appellant in support of his statement. The Income Tax Officer came to the conclusion that the accounts were false and eventually assessed his income at Rs. 8,000, and the

---

17. See Attorney General v. Lloyds Bank Ltd. (1944) 2 All. E.R. 157. It was held that where a person conceals a part of his income in violation of the Act, he would be liable to conviction regardless of the fact that under the particular circumstances of the case, the assessment would have been the same, had the assessee disclosed his true income. For instance, the assessee might have been entitled to the relief claimed, had he made the correct statement in the return.
18. (1937) 5 I.T.R. 610 (Nagpur).

Assessee was prosecuted under sections 182[19], 193[20] and 196[21], Indian Penal Code, 1860.

The appellant contended that there was no proof that the statement of income submitted was in fact false, and that all that had been proved was that there were certain omissions in the account, which would not suffice a conviction for giving false information under section 182, Indian Penal Code. While rejecting the appellant's contention, Pollock, J., said:

> "...This statement of income was based on the account books, and as those account books have been found to be false it necessarily follows that the statement of income was false."[22]

In P.D. Patel v. Emperor[23], the appellant, an advocate of the Rangoon High Court, was convicted under section 177 of the Indian Penal Code, 1860, read with section 52 of the Income Tax Act, 1922, for omission to include a sum of Rs. 15,000 (besides other small sums), received by way of commission for negotiating a loan, in his return for the year 1927-28.

---

19. Indian Penal Code, 1860, section 182 provides punishment for giving false information with intent to cause a public servant to use his lawful power to the injury of another.
20. Indian Penal Code, 1860, section 193 deals with prosecution for giving false evidence in any stage of judicial proceedings etc.
21. Indian Penal Code, 1860, section 196 provides punishment for using evidence known to be false.
22. (1937) 5 I.T.R. 610 at p. 613 (para 5).
23. A.I.R. 1933 Rang. 292.

The appellant contended that the income was an isolated transaction of a casual and non-recurring nature, within section 4 (3)(vii)[24] of the Act and in no way connected with any business or adventure carried on and that he honestly believed that it was not an item which ought to have been included in his return. It was held that the circumstances of the case would justify a conviction; the necessary guilty intention could be inferred from the fact that the appellant, though a skilled lawyer and well conversant with the provisions of law, did not disclose the said amount in his return of income. Page, C. J., rightly said:

> "...The appellant is a barrister-at-law and an advocate of this Court, who must have had a working knowledge of the provisions of the law relating to the filing up of forms prescribed for returning income assessable under the Income Tax Act. Indeed, the very defence to the charges connotes that the appellant was familiar with the provisions relating to receipts of a "casual and non-recurring nature"... the appellant was fully aware that all these sums were income, that it was incumbent upon him to disclose in his return of income for the year 1927-28."[25]

In Inspecting Assistant Commissioner of Income Tax v. Chotabhai Javerbhai and others[26], the Madras High Court held that the revenue must prove its case beyond all

---

24. Income Tax Act, 1922, section 4(3)(vii) provided that 'casual and non-recurring ' receipts were exempt from tax, provided they did not arise from business or the exercise of a profession, vocation or occupation.
25. A.I.R. 1933, Rangoon 292 at pp. 293, 294 (para 3).
26. A.I.R. 1941 Mad. 941.

reasonable doubt for a conviction in a taxation case as in other criminal cases.

The assessees, five in number, were partners of a firm 'Chotabhai Javerbhai', doing business in yarn and silver. The assessee firm's agent, accused no. 6, filed an income tax return on behalf of the firm showing Rs. 5,000 as its profit. On investigation the Income Tax Officer found that the firm had made profits of nearly 40,000, and that fraudulent entries had been made in the account books, with a view to defraud the Income Tax Department. The Assessee and the agent were prosecuted on various charges under section 52 of the Income Tax Act, 1922, and sections 193 and 196 of the Indian Penal Code, 1860.

The Court convicted the accused No.6 on the ground that he had authority both in law and in fact and that he was aware of the concealment of income. Their Lordships said:

> "...[I]t is difficult in the absence of some sort of explanation by accused 6, to understand how... an intelligent man of business should not be aware that his business was making a substantial profit (Rs.40,000 and more a year) and believe that his firm was doing so badly as to make only Rs. 5,000 a year."[27]

However, the accused 1 to 5 were acquitted on the ground that the prosecution did not prove that the

---

27. Ibid. at p. 943: Similarly, in U.S. v. Calderon, 348 U.S. 160, 167 (1954), the U.S. Court said that there could hardly be "more conclusive independent evidence of the crime" than proof of a deficiency in reported income of $30,000 over a four year period.

accused 1 to 5 knew beyond all reasonable doubt[28] that accused 6 was making a fraudulent return.

Section 278 of the Income Tax Act, 1961, for the first time made it an offence to abet or induce another person to make a false return, statement or declaration relating to income liable to tax.[29] There was no such provision in the earlier Acts, so the Income Tax Department had to resort to the provisions relating to abetment contained in Chapter 5 of the Indian Penal Code[30]. Section 278 of the Act of 1961 states:

---

28. The position is similar in the United Kingdom, United states of America, Canada, Australia and New Zealand. In Fottorrini Ltd. v. Inland Revenue, (1942) 1 All E.R. 619 (H.L.), Lord Wright said that the onus in penalty proceedings was not of an ambulatory or shifting character but the onus was finally on the Crown to prove its right to impose what was a severe penalty; see 'Prosecution for Attempts to Evade Income Tax: A Discordant View of a Procedural Hybrid', Steven Duke, (1966) 76 Yale L.J. p.1 at pp. 7-33; U.S. v. McCue (1962) 301 F.(2d) 452; Federal Income Taxes and the Civil Fraud Penalties, Raymond Whiteaker 7 Vend L. Rev. 366 at p.368 (1954) Acme Slide Fastener Co. Ltd. v. Thomas Edward Knott (The Queen),(1962) 62 D.T.C. 1261, See chapter 8, pp.471-84 for burden of proof.
29. Section 278 was incorporated in the Act of 1961 in pursuance of the recommendation of The Direct Taxes Administration Enquiry Committee, 1958-59. See para 7.72 at p.174; see Report of the Income Tax Investigation Commission 1949, para 241, p.107.
30. The Indian Penal Code (45 of 1860), section 107 defines 'abetment of a thing' in the following words:
"A person abets the doing of a thing, who-
First.- Instigates any person to do that thing; or
Secondly.- Engages with one or more other person or persons in any conspiracy for the doing of that thing, if an act or illegal omission takes place in pursuance of that conspiracy, and in order to the doing of that thing; or
Thirdly.- Intentionally aids, by any act or illegal omission, the doing of that thing."

(Continued on next page)

"If a person abets or induces in any manner another person to make and deliver an account, statement or declaration relating to any income chargeable to tax which is false and which he either knows to be false or does not believe to be true, he shall be punishable with rigorous imprisonment for a term which may extend to two years:
Provided that in the absence of special and adequate reason to the contrary to be recorded in the judgement of the Court, such imprisonment shall not be less than six months."[31]

The section appears to be wide enough to cover inducement or abetment of any sort by any person, including professional men[32]. Similar provisions are contained in the Income Tax Acts of the United Kingdom[33], the United States of America[34], Australia[35], Canada[36] and New Zealand[37].

---

30. (Continued from previous page) Halkori Ram and others v. King Emperor, (1941) I.T.R. 209 (Patna). Charges were framed against the accused under section 109 of the Indian Penal Code for having abated the offence under section 52 of the Income Tax Act, 1922, there being then no such provision in the Income Tax Act.
31. See *supra* note 7.
32. 'The Law and Practice of Income Tax', J.B. Kanga and N.A. Palkhivala, 6th ed. Vol.I. (1969), p. 1047.
33. Taxes Management Act, 1970, section 99, provides penalty for assistance in making incorrect returns, etc.
34. Internal Revenue Code, 1954, section 7206(2).
35. See 'Gunn's Commonwealth Income Tax Law and Practice,' 6th ed. (Butterworth 1960), see 3421 at p. 1429. The provisions relating to aiding and abetting contained in sec. 5 of the Commonwealth Crimes Act 1914-1969 also apply in case of income tax offences.
36. Income Tax Act (RSC 1952, c 148) section 132 (1)(3).
37. Land and Income Tax Act (67 of 1954), section 228 (1)(e).

Failure to Co-operate in Search and Seizure

The Income Tax Act, 1961[38], like the earlier Acts of 1922[39], 1918[40] and 1886[41], has given various powers to the Income Tax authorities to enable them to make the assessment of tax in as reasonable and equitable a manner as possible[42], and for catching the tax evader and establishing, beyond doubt the fact of concealment[43]. The powers of search and seizure, to compel the production of a taxpayer's record and to unearth the evidence which might not be available to an investigating agency[44], are among the powers under the Act. But this power is to be exercised within limits prescribed by the Act. This is necessary to ensure the fundamental right to privacy and freedom enshrined

---

38. Income Tax Act, 1961, sections 125,126,127, 131 to 136.
39. Income Tax Act, 1922, sections 5(5),5(6),5(7A), 37 to 39.
40. Income Tax,Act, 1918, sections 27 to 29.
41. Income Tax Act, 1886, sections 28 (dealt with the power to summon witnesses.
42. Report of the Direct Taxes Administration Enquiry Committee (1958-59); Government of India, para 7.43,p.159.
43. 'Searches, Seizures and Self-Incrimination', Norman Redlich (1955) 10 Tax L. Rev. 191. See 'Development of the Law of Search and Seizure', L.H. Leigh (1970) Mad. L.R. 268-280.
44. 'Power of Search and Seizure', M.P.Jain (1969) 11, J.I.L.I. 535. See Gianchand v. State of Punjab, A.I.R. 1962 S.C. 496. The Supreme Court has defined the expression 'seized' appearing in Section 178A of the Sea Customs Act, 1878, as to 'take possession of contrary to the wishes of the owner of the property.' at p.499, para 7.

in the Constitution[45], and to safeguard the affected person's reputation and business[46].

The power of search and seizure was for the first time given to the Income Tax authorities by the insertion of sub-section (2) of section 37[47] in the Income Tax Act, 1922, by the Finance Act, 1956, in pursuance of the recommendation of the Taxation Enquiry Commission, 1958-59[48]. Section 132 in the Income Tax Act, 1961, is the provision corresponding to sub-section (2) of section 37 of the Act of 1922 with slight modifications. Clauses (i) to (v) of sub-section (1) of section 132[49] of the Act of 1961 empower the specially authorized Income Tax authorities:

> "(i) to enter and search any building or place where he has reason to suspect that such books of account, other documents, money, bullion, jewellery or other valuable article or thing are kept;

---

45. The Constitution of India, Article 19(1)(d) and (e) provides fundamental right of residence, which includes the right of privacy as well.
46. *Supra* note 44, p.535.
47. Income Tax Act, 1922, section 37(2) gave power of search and seizure to the Income Tax Officer specially authorized by the Commissioner in this behalf.
48. *Supra* note 42, para 7.43, at p. 159; *Report of the Taxation Enquiry Commission 1953-54*, Vol.II, para 33 at p. 201. The Income Tax (Amendment) Bill of 1938 enacted a clause to give powers of search and seizure but it could not be enacted owing to opposition to it by the Legislature.
49. The present section 132 of the Income Tax Act, 1961, was substituted by the Finance Act, 1964, with effect from the 1st April, 1964. See *Board of Revenue, Madras* v. *R.S. Jhaver*, A.I.R. 1968, S.C. 59; *Sheonath Prasad* v. *State of Bihar* A.I.R.,1968, S.C.15 17; State of *Rajasthan v. Rehman*, A.I.R. 1960, 5 S.C. 210.

> (ii) break open the lock of any door, box, locker, safe, almirah or other receptacle for exercising the powers conferred by clause (i) where the keys thereof are not available;
> (iii) seize any such books of account, other documents, money, bullion, jewellery or other valuable article or thing found as a result of such search;
> (iv) place marks of identification on any books of account or other documents or make or cause to be made extracts or copies thereof from;
> (v) make a note or an inventory of any such money, bullion, jewellery or other valuable article or thing."

In case it is not practicable to seize any such books of accounts or documents, such officer may, under sub-section (3) of section 132;

> "... serve an order on the owner or the person, who is in immediate possession or control thereof, that he shall not remove, part with or otherwise deal with it, except with the previous permission of such officer..."

Section 275A of the Act, which was inserted by the Income Tax (Amendment) Act, 1965, imposes criminal liability on persons acting in violation of such order. Section 275A provides,

> "Whoever contravenes any order referred to in sub-section (3) of section 132 shall be punishable with rigorous imprisonment which may extend to two years and shall also be liable to fine."

Disclosure of Confidential Information

The Income Tax statutes have invariably[50] treated all documents filed or statements made or furnished to the Income Tax authorities as confidential in nature. The

50. See Income Tax Act, 1886, section 38(2) and (3); Income Tax Act, 1918, section 42; Income Tax Act, 1922, Section 54; Income Tax Act, 1961, section 280.

reason being, as stated by C.P. Sinha, J., in Srimati Pandei v. Babulal Sah:

> "... [T]he assessees should feel that they can freely state the facts with regard to their income, which might involve confidential matters relating to their business without fear of the matter being disclosed. It is with that end in view, to give absolute freedom to the income tax assessees to make statements of their income to the department, untrammelled by any fear of disclosure of those statements, that such restrictions have been imposed on the grant of copies and production of such documents."[51]

Accordingly, it has been provided that, if any public servant[52] is found guilty of a breach of confidence reposed in him under the Act, he is liable to conviction on prosecution before a court of law, with the previous approval of the appropriate authorities[53].

It is interesting to note that the Income Tax statutes since the Act of 1922, have progressively relaxed the rule of absolute prohibition of disclosure, laid down in the Act of 1918, so as to bring the pressure of social calumny on tax dodgers[54]. Section 42 of the Income Tax Act, 1918 stated:

---

51. A.I.R. 1958 Pat 237 at p. 238, (para 3); Emperor v. Osman Chotani, (1942) I.T.R. 429 (Bombay); Promatha Nath v. Nirod Chandra Ghose (1939) I.T.R. 570,572; Shama Rao v. Motiram (1934) I.T.R. 436, 438, Report of the Taxation Enquiry Commission 1953-54, Government of India, Vo. II, p. 203 (para 40); Report of the Income Tax Investigation Commission, 1949, Government of India, para 244 at p. 108.
52. Income Tax authorities are 'public servants' under section 21 of the Indian Penal Code, 1860; supra note 42, para 7.67 at p. 171.
53. See infra pp.414-21 for provisions relating to sanctions.
54. Report of the Taxation Enquiry Commission 1953-54, Vol. II Government of India, para 40, p. 203.

> "All particulars contained in any statement or return made or furnished under the provisions of this Act shall be treated as confidential, and if a public servant discloses any particulars contained in any statement or return made or furnished under this Act, he shall be punishable with imprisonment, which may extend to six months, and shall also be liable to fine."

Section 54 of the Income Tax Act, 1922, corresponding to section 42 of the Act of 1918, after stating that information furnished to the Income Tax authorities was confidential, enumerated in clauses (a) to (p) of sub-clause (3), a number of particulars, for disclosure of which the public servant was immune from prosecution. Similarly, section 137 (now deleted) of the Income Tax Act, 1961, in sub-section (3), clauses (i) to (xxi), gave a list of various particulars, to the disclosure of which the prohibition did not apply. Later it was realized that a threat of punishment for diclosure of information given to Income Tax authorities did not serve any useful purpose, when so many exceptions were recognized. Moreover, it was an encouragement to tax evaders to afford undue protection to statements furnished to the Income Tax authorities[55]. Accordingly section 137 of the Act of 1961 was deleted by section 32 of the Finance Act, (5 of 1964), with effect from the 1st April, 1964. The result is that

---

55. See Report of the Income Tax Investigation Commission, (1949), Government of India, paras 243, 244, p. 108.

the prohibition against disclosure is now limited to the documents specified in the orders issued by the Central Government under sub-section (2) of section 138 of the Act of 1961, which states:

> "...[T]he Central Government may,... direct that no information or document shall be furnished or produced by a public servant in respect of such matters relating to such class of assessees or except to such authorities as may be specified in the order."

If a public servant acts in contravention of such order, he is liable to conviction under section 280 of the Act, which states:

> "(1)... [H]e shall be punishable with imprisonment which may extend to six months, and shall also be liable to fine."

This provision appears to be similar to that contained in section 38 of the Income Tax Act, 1886. The relevant portion of which provided:

> "(1). The Governor-General in Council may make rules consistent with this Act... for preventing the disclosure of particulars contained in documents delivered or produced with respect to assessment... (2)...The Governor-General in Council may direct that a public servant committing a breach of the rule shall be deemed to have committed an offence under section 166 of the Indian Penal Code."[56]

<u>Sanction for Prosecution</u>

As the very idea of criminal prosecution brings a feeling of horror to the mind of a respectable man, it is not to be initiated as a matter of course. A case is

---

56. Section 166 of the Indian Penal Code punishes any public servant who knowingly disobeys any direction of law as to the way he is to perform his duty, knowing it to be likely that such disobedience will cause injury to any person.

to be thoroughly prepared for investigation, scrutinized and thrashed out before the machinery of the law is set in motion. The decision to prosecute calls for a mature and and expert brain[57]. Perhaps, with this end in view, and to ensure sufficient safeguards[58] from taxpayers being unduly harassed, the legislature in India has provided in sub-section (1) of section 279 of the Act of 1961[59], and the corresponding sections of the Acts of 1922[60], 1918[61], and 1886[62], that criminal proceedings under sections 275A to 278 should be instituted only at the instance of the Commissioner of Income Tax[63]. And sub-section (2) of section 279 makes the tax offences compoundable[64] before or after the institution of such proceedings. The Courts appear to have been very rigid and have attached much significance to the technicalities of law in applying these provisions.

---

57. Supra note 72, sec.48.44 at pp. 457-9.
58. T.S. Baliah v. T.S. Ranga Chari, A.I.R 1969 S.C. 701.
59. Ibid., para 7 at p. 706.
60. Income Tax Act, 1922, section 53: Inspecting Assistant Commissioner.
61. Income Tax Act, 1918, section 41: Collector.
62. Income Tax Act, 1886, section 36: Collector.
63. Income Tax Act, 1961, section 279 (1A) provides that no prosecution shall be instituted under section 277 if the penalty has been reduced or waived.
64. To constitute a valid compromise of an offence, there must be an agreement between the parties; and the parties must be fully aware of their rights and there must not be any undue pressure or coercion or fraud by any one of the parties. See the Code of Criminal Procedure (Act 5 of 1898), section 345; provisions relating to compromise are also found in the laws of the United Kingdom and the United States of America. See Tax Management Act, 1970, section 54 which provides for settling of appeals by agreement, and Internal Revenue Code, 1954, section 7122: 'Tax Fraud and Evasion', Harry Graham Balter, 3rd ed. (1963), Chapter 7 for compromise procedure.

In Bankat Lal v. Emperor[65] as long ago as 1914, in a case under section 35 of the Act of 1886, it was held that, though the offices of Collector and District Magistrate were held by one man, the prosecution would be illegal, if the proceedings were instituted on a complaint signed by him as district Magistrate, not as collector.

However, there appears to have been a change in the attitude of the courts since 1914. The Supreme Court held in T.S. Baliah v. T.S. Rangachari, I.T.O., Madras[66], that a prosecution would not be illegal on the ground that it was not instituted by the Inspecting Assistant Commissioner under section 53 of the Act of 1922, if the proceedings were in fact launched at the instance of the proper authority. The Court rightly said:

> "The clause 'at his instance' in Section 53 of the 1922 Act only means 'on his authority' and it is therefore sufficient compliance [sic] with the statutory requirement if the complaint petition is filed by the respondent on being authorized by the Inspecting Assistant Commissioner."[67]

In Hari Chand v. Emperor[68], the petitioner was convicted under section 177 of the Indian Penal Code[69]

---

65. (1914)12 All A.L.J.258; re Mohideen Pakkiri Marakkayer A.I.R. 1923 Mad. 50. A charge in respect of false statement in verification could be tried only by the court having jurisdiction over the place where the return was received and not where it was filed, Jagdeo Sahu v. Emperor (1917) 15 All. L.J. 163.
66. A.I.R. 1969 S.C. 701.
67. Ibid. at p. 766 (para 7).
68. A.I.R. 1934 Lah. 626.
69. Section 177 of the Indian Penal Code punishes furnishing false information by a person legally bound to furnish information on any subject.

read with section 52 of the Income Tax Act, 1922, for making a false verification in a return. The return was submitted by the assessee, not in pursuance of a notice by the Income Tax Officer under section 22(2) of the Act of 1922, but on his own accord. It was held that the conviction was illegal. The Court stated that the assessee was not bound to make a return, if he had not received a notice to do so and criminal liability would not accrue in a case of a return filed suo motu.

However, the decision does not hold good now[70], in view of the fact that the Act of 1961 has imposed a statutory liability on the part of every person under section 139(1)[71] to file a return of his income to the Income Tax Officer each year without being served any notice to do so by the Income Tax Officer.

In Champalal Girdharilal v. Emperor[72], Nagpur High Court adopted too a technical view and held that in a case of lack of proper sanction, the proceedings were illegal. The appellant was convicted by a magistrate for an offence under section 52 of the Income Tax Act, 1922, for making a false statement in his declaration attached to the income tax return. The prosecution was instituted, as required under section 53 of the Act of 1922, at the instance of

---

70. Supra note 32 at p. 1046 (f.n.1).
71. See Chapter 2, for section 139(1) of the Act, pp.47-9.
72. A.I.R. 1933, Nag. 358.

the Appellate Assistant Commissioner. On appeal, the additional Sessions Judge found that the accused had not committed an offence under section 52 but under section 51(1)(c) (for failure to file return in time) and therefore altered the conviction to one under the latter section. But it was held in revision that the offence under section 51(1)(c) was of a different nature from that under section 52, and, as there was no sanction for a prosecution under the former, the conviction was illegal[73]. The Court disagreed with the Sessions' Judge's view that, though the sanction of the Assistant Commissioner was only for prosecution under section 52, there was no bar to a prosecution under section 51(1)(c).

Admittedly, criminal provisions must be strictly construed but the Nagpur High Court's view appears to have been overruled by the Supreme Court in Shamrao Bhagwantrao Deshmukh v. Dominion of India[74].

Though the decision relates to compounding of offences committed under section 52 of the Income Tax Act, the decision appears to be relevant. P.D. Deshmukh, deceased, who was the manager of a Joint Hindu family at the relevant time, admitted on examination before the Appellate Assistant Commissioner that he had concealed a

---

73. In R. v. Barre Ltd. (1947), 88 Can. Crim. Cas. 397, a Canadian case, it was held that the authority to prosecute must refer to a specific offence.
74. A.I.R. 1955 S.C. 249.

sum amounting to Rs. 30,000 from the return submitted by the attorney having authority, for the year 1928-29. He was told that he would be prosecuted under section 52 of the Act. As a result, Deshmukh paid the sum to the Income Tax Department and the offence was compounded under section 53(2) and the matter was closed.

In June, 1934, the two cousins of P.D. Deshmukh, who were coparcerners, filed a suit against the State for the recovery of the sum so paid, on the ground that P.D. Deshmukh's statement was incorrectly recorded, that the money was extorted from him under the threat of legal prosecution, that the omission was due to the mistake of the agent, and that he was not liable to be prosecuted under section 52 of the Act.

The Court rejected all these contentions and held that there was no coercion and the offer of compromise was made by P.D. Deshmukh voluntarily, to avert the disgrace and ignominy of a prosecution. As regards the second contention, Mahajan, C.J., said:

> "...[E]ven if it be assumed that P.D. Deshmukh was not liable to be prosecuted under section 52, because of the verification being made by his agent and not by himself, that there was no return by him under S.22, of the Income Tax Act, his liability under S.51(c) for failing without reasonable cause or excuse to furnish in due time any of the returns mentioned in S.22, sub-s, (2) would nevertheless remain unaffected.
> Whether his liability arose under S.51 for failure to furnish the return, as required by S.51(c), or for making a false statement in the return as contemplated by S.52, it made no difference to the authority of the Assistant Commissioner to permit the composition of the offence under section 53. That section covers

> both offences under sections 51 and 52. There can be no doubt therefore that P.D. Deshmukh could be prosecuted either under S. 51(1)(c) or S.52 and even if he had been prosecuted by the Income Tax authorities under S.52 only, there was nothing to prevent the Court from altering the charge to one under S.51(1)(c), if it thought fit."[75]

It may be observed that the Department should resort to prosecution in preference to compromise in flagrant cases of concealment and fraud in view of the large scale evasion of taxes in the country[76]. This might result in loss of revenue to the exchequer, but it will be fruitful in the long run as it will deter tax-dodgers and those who are like-minded. It will remove the deep-rooted feeling in the public mind that justice can be purchased with money and the sword of the law is for the poor and not the rich. It may be noted that the Income Tax Act, 1886, had no provision for compromise of criminal prosecutions under the Act[77].

The provisions relating to compromise in criminal prosecutions contained in sub-section (2) of section 279 of the Act of 1961, should either be deleted, or at least amended to the extent that the compromise should be made

---

75. A.I.R. 1955 S.C. 249 at pp. 251, 252; (para 5.). Similarly in the United Kingdom a taxpayer is bound by the terms of the agreement to pay a sum in consideration of no proceedings for penalties being taken. C.I.R. v. Richards (1950) 33 T.C.I.; Attorney General v. Johstone (1924-26) 10 Tax Cases 758.
76. Report of the Working Group: Administrative Reforms Commission, (Government of India), 1968, para 6.28, p.122.
77. Income Tax Act, 1886, section 36.

only with the leave of the Court[78] before which the prosecution for the offence is pending as provided under clause (2) of section 345[79] of the Criminal Procedure Code for the offences mentioned in the first two columns of sub-section (1) of section 345 of the Code. This will bring uniformity in criminal prosecutions under the law of taxation and the general Criminal law of the country.

Penalties Outside the Income Tax Act.

Criminal prosecutions under the Indian Penal Code may be instituted for violations of the revenue laws, although the Income Tax Act provides most of the criminal sanctions[80]. The Courts have approved the use of the broad penal sanctions contained in the Indian Penal Code, since the very inception of the Income Tax Acts[81], either in combination with criminal provisions of the Income Tax Act or in preference to them[82]. The Income Tax authorities[83]

---

78. 'Report of the Working Group on Central Direct Taxes Administration (1968) para 6.28 at p.122; Report of the Direct Taxes Administration Enquiry Committee 1958-59, has also suggested that a compromise in criminal prosecutions should be resorted only in exceptional cases, para 7.69. at p. 172.
79. See The Criminal Procedure Code (5 of 1898), section 345 (1) and (2) for provisions relating to compromise in cases under the Indian Penal Code.
80. Income Tax Act, 1961, sections 275A,276,276A, 276B,277 and section 278.
81. R.v. Dayalji Enderji, (1871) 8 Bom. H.C.R. 21(Cr.C.) In re Punamchand Maneklal (1914) 38 I.L.R. Bom. 642 (F.B.) In re Natara Ja Iyer, I.L.R. (1913) 36 Mad. 72; Ganga Sagar v. Emperor, A.I.R. 1919 All 919; Halkhori Ram v. Emperor, (1941) I.T.R. 209; Inspecting Assistant Commissioner v. Chotabhai Javerbhai and others, A.I.R. 1941 Mad.941; P.D. Patel v. Emperor, A.I.R. 1933 Rang. 292; K.C.V. Reddy v. Emperor, A.I.R. 1930 Rang. 201.
82. T.S. Baliah v. Rangachari, A.I.R. 1969 S.C. 701.
83. See supra Chap 2, pp. 42-45 for various category of Income Tax authorities

are 'public servants' within the meaning of section 21 of the Indian Penal Code and income tax proceedings are judicial in nature[84]. As such an Income Tax Officer may institute a complaint before a criminal court for an offence committed before him[85].

One may question the desirability of the use of general criminal sanctions in Income Tax cases, when the Income Tax Act itself provides punishment for infringement of its provisions. In fact, this issue was debated with much ingenuity and eloquence by the counsel for the appellant in T.S. Baliah v. T.S. Rangachari, I.T.O., Madras[86], before the Supreme Court of India.

The appellant was a cine-actor. Four complaints were filed by the Income Tax authorities against the appellant before the Presidency Magistrate, Madras, in respect of income tax returns submitted for the assessment years 1958-59 to 1961-62. The first three complaints were related to assessment years 1958-59, 1959-60 and 1960-61 under section 52 of the Act of 1922, and under section 177, Indian Penal Code; the fourth was in respect of assessment year 1961-62 under section 277 of the Income Tax Act, 1961, and section 177, Indian Penal Code. In substance, the charge was that the appellant had been systematically filing

---

84. Income Tax Act, 1961, section 136.
85. Supra note 32 at p. 1046.
86. A.I.R. 1969 S.C. 701.

false returns of his income and had made false statements in verification, knowing them to be false and wilfully omitted and deliberately suppressed the inclusion of the receipt of certain sums of money in his income tax returns, with a view to evade lawful taxes due to the Government.

It was contended on behalf of the appellant that the provisions of section 52 of the Act of 1922 being a special provision, he should be liable to prosecution under that provision only and not under section 177, Indian Penal Code. In respect of the matter covered by section 52 of the Act of 1922, the provisions of section 177 I.P.C. should be taken to have been repealed by implication, so that the prosecution of the appellant under section 177 was illegal.

The Court held that there being no repugnancy or inconsistency between the two enactments, they could stand together and be treated as cumulative in effect. Ramaswami, J., delivering the judgement of the Court said:

> "... The provisions enacted in Section 52 of the 1922 Act do not alter the nature or quality of the offence enacted in Section 177, Indian Penal Code, but it merely provides a new course of procedure for what was already an offence. In a case of this description, the new statute is regarded not as superseding, nor repealing by implication the previous law, but as cumulative... In cases such as these, it is to be presumed that the legislature knew that the offence was punishable by indictment and that, as it did not in express terms abolish the common law proceeding, it intended that the two remedies should co-exist."[87]

---

87. Ibid. at p. 704 (para 4).

The observation of Krishnaswami Reddi, J, of Madras High Court, makes the point clearer where he says:

> "... [T]he subject-matter of the offence under section 177, I.P.C. is much wider and comprehensive than the subject-matter of the offence created under section 52 of the Income Tax Act for the purposes of enforcing effectively the provisions of the said Act. The Indian Penal Code is a penal statute, whereas the Income Tax Act is fiscal and deals with revenue... The object and the purpose of the two enactments being different and the offence under the enactment being wider than the other,... it would not have been intended by the later enactment to repeal the earlier."[88]

The Court further held that there is no bar to the trial or conviction of the offender under section 177, Indian Penal Code, 1860, and section 52 of Income Tax Act, 1922, at the same time. The position under the Act of 1961 is the same.

Similarly, in the United Kingdom a person may be prosecuted for fraud at common law[89], or for offences under the Perjury Act, 1911[90], or for conspiring to defraud the revenue.[91]

In R. v. Hudson[92], a leading case on the point, the question was raised whether common law would apply in cases of revenue offences. The appellant was convicted on

---

88. T.S. Baliah v. T.S. Rangachari, A.I.R. 1969 Mad. 145 at p. 149 (para 14).
89. R v. Hudson (1956) 2 Q.B. 252; 'Common Law Prosecutions and Revenue Fraud (1956) B.T.R. 119.
90. R. v. Bradbury, R. v. Edlin, (1921) 1 K.B. 562; R.v. R. v. Hood-Barrs, (1943) 1 K.B. 455.
91. Halsbury's Laws of England, Vol. 20, 3rd ed., (1957), at p. 720.
92. (1956) 2 Q.B. 252; (1956) 1 All E.R. 814.

December 8, 1955, of making false statements, with intent to defraud, in that he had sent to the Inland Revenue accounts, which falsely stated the profits of his business for the years 1945 to 1955 and also a certificate of disclosure, which he knew to be false.

On appeal against the conviction, the appellant contended that the offence charged was unknown to the law, i.e., not provided for by the Income Tax Act, 1952, or by the Perjury Act, 1911. It was held that the appellant was rightly convicted, since the offence charged disclosed the offence of fraud on the Crown and the public, which was indictable as a common law misdemeanour. Lord Goddard, C. J., delivering the judgement of the Court said:

> "... [B]ecause the offence is not provided in any particular section of any particular Act, there is no reason why, if what is done is an offence at common law, it should not be prosecuted as such."[93]

In the United States of America also criminal penalties contained in the Federal Criminal Code are invoked in revenue cases[94]. The most important criminal

---

93. Ibid. at p. 815; Similar view was taken in R.v.J. (1963) N.I. 73.
94. 'Tax Fraud and Evasion,' Harry Graham Balter (1963, Chapter 11.2: U.S. v. Beacon Brass Company, Inc., and Maurice Feinberg, 344 U.S. 43 (1952). The Supreme Court held that prosecution for making false statements to representatives of the Treasury Department for the purpose of concealing unreported income is punishable under section 35A of the Criminal Code of 1901 (similar to section 1001 of the present code), even though the similar conduct had been specifically covered under section 145(b) of the Internal Revenue Code of 1939 (section 7203 is the present section under I.R.C. 1954). Justice Minton said:
"... A single act or transaction may violate two or more criminal statutes... Being distinct, each of the statutes is to be enforced as it was written."

sanctions which are in vogue are (1) perjury[95] (2) presenting false claims or making false statements[96]; and (3) conspiracy[97].

It may be noted in this connection that the Income Tax Department in India does not take a serious view of tax crimes. The Department rarely has to resort to the criminal provisions available under the Income Tax Act and under the Indian Penal Code[98]. The provisions are a dead letter. This detached view of the Department helps unscrupulous taxpayers in evading taxes. This might be because of the Department's preference to realize money by imposing administrative penalties instead of seeking criminal prosecution, and lack of proper facilities for preparing tax evasion cases[99], the difficulty in procuring evidence for criminal prosecutions because of the heavy burden of proof, the general reluctance of the Courts to convict a taxpayer for violation of tax laws, the lack of social consciousness and the involvement of influential people in general in such types of offences. But this is not going to help, if tax crimes are to be checked and minimized.

---

95. Title 18 of U.S.C., 1948 C. 1621; Cooper v. U.S., 233 F, (2d) 821 (8th Cir 1956); (William C)Siravo v. U.S. 1967 (CA1), 377 F(2d) 469.
96. Title 18 U.S.C. 1948 , S. 1001, U.S. v. McCue, (1962) 301, F (2d) 452.
97. Title 18. U.S.C. 1948, Section 371; Herry W. Grunewald v. U.S. 353 U.S. 391 (1957).
98. See supra Chapter 5, p. 229 for number of prosecutions
99. See supra Chapter 5, pp. 215-61 for various causes of tax evasion.

It is high time for the Department to make use of the penal provisions more frequently[1], because criminal sanctions are one of the most effective deterrents against tax evasion[2]. The Income Tax Department appears to have ignored the recommendation of the Direct Taxes Administration Enquiry Committee, 1958-59, that the Department should have recourse of the penal provisions of the Indian Penal Code rather than those in the taxing statutes[3], which would be a step in the direction of tax crime control, because the provisions of the Indian Penal Code are more stringent than those in the Income Tax Act. A clause similar to that of section 104[4] of the British Taxes Management Act, 1970, might be added in the Income Tax Act, directing the Income Tax Department to take action under the Indian Penal Code in appropriate cases.

---

1. Supra note 88, para 6.28, at p. 122.
2. 'Report of the Direct Taxes Administration Enquiry Committee 1958-59, para 7.66 at p. 171.
3. Ibid, para 7.65 at p. 170.
   See 'The Crimes of Income Tax Fraud': Its Present Status and Foundation', (1953) 52 Columbia L. Rev., 476,478.
4. Taxes Management Act, 1970 (9 of 1970), section 104 states:
   "The provisions of the Taxes Acts shall not, save so far as is otherwise provided, affect any criminal proceedings for any misdemeanour."

CHAPTER VIII

JUDICIAL REVIEW

The Nature of Penalty Proceedings in India

In the preceding chapters a detailed study of legislative measures to combat tax evasion has been made. In this chapter an attempt is made to review the judicial trend in some important areas of tax crimes. The judiciary being the final arbiter of legislative action[1], the success of tax legislation, like that of any other enactments, depends on how the courts view the intention of the planners, as manifested in legislative enactments[2].

The Income Tax Act, 1961, as stated earlier[3], provides two types of penalty for defaults committed under the Act, i.e., one enforced by the Income Tax authorities and the other by the criminal courts. There seems to be no controversy as regards the latter type of penalty, which is criminal in nature. The very title to chapter 22, "Offences and Prosecution" is indicative of this fact. The real difficulty arises in relation to the former type of penalty. The question that has long puzzled those interested is the nature of penalties imposed extra-judicially by the administrative authorities. The point

1. 'The Courts and the Legislature in India', P.K. Irani, (1965) 14, International and Comparative Law Quarterly, 950.
2. 'Statutory Interpretation' and the Welfare State', Sheldon D. Elliot (1959-60) 2, J.I.L.I., 267, at p.258.
3. See Chapter 6, pp263.

has been agitated from time to time, but is still unresolved. There seems no consensus amongst the judges[4]. Some of the courts hold that the nature of such penalties is criminal[5], while others opine that it is civil, i.e., it is a mere imposition of additional tax[6] and others still would categorize it quasi-criminal[7].

---

4. C.I.T., Calcutta v. Anwar Ali, A.I.R.1968 Cal. 345 at p.351. (para 17).
5. C.I.T., Ahmedabad v. Gokuldas Harivallabh Das A.I.R.1959 Bom.96; Khemraj Cheganlal v. C.I.T. A.I.R. 1960, Pat. 252; Bhagwandas Shyamsundar v. C.I.T. (1962) 45, I.T.R. 586 (Pat); Mohd. Atiq v. I.T.O. (1962) 46, I.T.R. 452 (All); P.K. Kalasami Nadar v. C.I.T. (1962) 46 I.T.R. 1056 Mad.; Money and Co. v. C.I.T. (1963) 47 I.T.R. 434, (Ker.); Lakshmi Narain Shambhuram v. C.I.T. (1963) 49 I.T.R. 350 (Pat); M. Hussaion Ali and Sons v. C.I.T. (1965) 58 I.T.R. 787 (Mad); Mohan Ram Ram Kumar v. C.I.T. (1966) 59 I.T.R. 135 (All); S. Paramasiva Mudaliar and Sons v. C.I.T. (1966) 60 I.T.R. 283 (Mad); Mangilal Karwa v. C.I.T. Misc. Civil Case No. 113 of 1962 Dated 14.9.62 (M.P.); C.I.T., E.P.T., A.P. v. Hamaswami Chetty (1967) 64 I.T.R. 388 (A.P.); C.I.T., Gujarat v. L. H. Vora, (1965) 56 I.T.R. 126 (Guj); P.S.S. Bommonna Chettiar v. C.I.T., Madras (1969) 73 I.T.R. 26 (Mad); C.I.T., M.P.v. Champalal A.I.R. 1969 Mad. Pra. 72
6. Lalchand Gopal Das v. C.I.T., U.P. and V.P.(1963) 48 I.T.R. 324 (All); Murlidhar Tejpal v. C.I.T., Patna (1961) 42 I.T.R. 129 (pat); A.V. Thomas and Co. Ltd. v. C.I.T., Madras, I.L.R. (1967) 1 Mad. 255.
7. C.I.T., Calcutta v. Anwar Ali A.I.R. 1968 Cal 345, 352 (para 27); Hindustan Steel Ltd. v. State of Orissa A.I.R. 1970 S.C. 253. The case relates to Sales tax law in which their Lordships stated such proceedings to be as quasi-criminal. Bhajuram Ganplat Ram v. C.I.T. Bihar and Orissa A.I.R. 1970 Orissa 38, at p.40 (para5).

The protagonists of the first view hold that the nature of the penal proceedings under the Act in general, and under section 271(1)(c) in particular, being criminal, the principles of criminal jurisprudence will apply in such proceedings. In other words, the following conditions must be satisfied before a person is penalized for defaults committed under the Act, viz.,

(i) the burden of proof that the assessee has concealed the particulars of income ,or has furnished inaccurate particulars of such income or failed to submit the return in time, or comply with notices or furnish necessary information under the Act, intentionally, or without reasonable cause, lies on the Income Tax Department;

(ii) it must be established beyond reasonable doubt that the assessee has committed such default, and

(iii) the finding in assessment proceedings that an assessee has concealed income is not sufficient for the purpose of imposition of the penalty.

The majority of High Courts have approved of this view,

The Bombay High Court in C.I.T., Ahmedabad v. Gokul Das Harivallabh Das[8], dealt with the question of the nature of penal proceedings for the first time. Chagla C.J., in one of his classic pronouncements, said:

---

8. A.I.R. 1959 Bom. 96. See chapter 6 p.303 for facts of the case.

> "...The proceedings under S.28(1)(c) in their very nature are penal proceedings, and the elementary principles of criminal jurisprudence must apply to these proceedings, and nothing is more elementary... in criminal jurisprudence than the principle that the burden of proving that the accused is guilty is always upon the prosecution."[9]

He further observed that the nature of such proceedings calls for a strict standard of proof. He stated:

> "...[E]ach proceeding under the Income Tax Act is a self-contained proceeding and the findings in one proceeding do not become binding in respect of other proceedings,.. The assessment proceedings are taxing proceedings; the penalty proceedings are criminal proceedings in their very nature, and a decision given in an assessment proceeding cannot possibly be binding upon the authority who tries the assessee for an offence."[10]

The Madhya Pradesh High Court in one of its recent cases, <u>C.I.T.,M.P.</u> v. <u>Champalal Sukhuram</u>[11], held that a penalty proceeding is not a procedding for the imposition of additional tax. Accordingly, the quantam of evidence required for the levy of a penalty would not be the same as that required for the purpose of inclusion of an additional amount in the total income of the assessee for the purpose of assessment.

In another case, <u>C.I.T.,M.P.</u> v. <u>Punjabhai Shah</u>[12], the Madhya Pradesh Court held that the penalty proceedings, being in their very nature penal proceedings, the degree and quantam of proof necessary for finding an assessee

---

9. A.I.R. 1959 Bom. 96 at p.97 (para 3).
10. <u>Ibid</u> at p. 98 (para 4).
11. A.I.R. 1969 M.P. 72.
12. A.I.R. 1968 M.P. 103.

guilty is the same as in a criminal prosecution. The facts were that the assessee's total income for the assessment year 1959-60 was estimated at Rs. 10,953. However, the Income Tax Officer later found that the assessee had purchased a motor vehicle for Rs. 31,250, regarding which nothing was mentioned in the return.

The assessee's explanation, that on 26th August, 1958 he had a cash balance of Rs. 14,168 and out of it he made payments of Rs. 1000 and Rs. 9,000 on 26th August and 9th September 1958, was rejected by the Income Tax authorities. The Income Tax Officer found that there were no entries in his accounts showing the withdrawal of Rs. 1,000. There were certain jottings in pencil in the Rokad[13] and, if the payments had been actually made from the cash balance, then these amounts would have appeared merged in the rokad entries themselves and not in the pencil jottings. The Income Tax Officer further discarded the assessee's statement that Rs. 21,250 was the depreciation allowance on his trucks for the assessment years 1957-58 to 1959-60, which had been utilized in purchasing the vehicle, as false. The Income Tax Officer, therefore, declared the sum of Rs. 31,250/- to be income from undisclosed sources in the assessment year 1959-60 and the Inspecting Assistant Commissioner imposed a penalty of Rs. 5,000 under section 271 (1)(c) of the Act of 1961.

---

13. Rokad means 'account'.

Rejecting the appellant's claim to set aside the penalty, the Court said:

> "...The assessment proceedings and penalty proceedings are different in their nature. The findings given in assessment proceedings are no doubt relevant and admissible in penalty proceedings, but they do not operate as res judicata, so as to preclude the production of other evidence in penalty proceedings to show that the assessee concealed his income or to rebut this charge. Again, the bare fact that the explanation offered by the assessee in assessment proceedings was rejected and it was held in those proceedings that he had concealed his income or that the explanation was unsatisfactory by itself cannot be made the basis of the conclusion that he has been guilty of deliberately concealing the particulars of his income."[14]

The Kerala High Court in Money and Co., v. C.I.T., Kerala, similarly said:

> "...[T]he degree of proof is that of a criminal prosecution and that the mere preponderance of probability will not suffice as in the case of a civil action."[15]

The Madras High Court in Gnanmbika Mills Ltd. v. C.I.T. Madras[16], M. Hussain Ali and Sons v. C.I.T., Madras[17] and P.K. Kalasami Nadar v. C.I.T., Madras[18], expressed concurrence with the views of the Bombay High Court in Gokuldas Harivallabhdas[19], regarding the nature of the penalty proceedings under the Act. The Court said that proceedings under section 28(1)(c) of the Act of 1922 (corresponding to section 271(1)(c) of the Act of 1961) were in the nature

---

14. A.I.R. 1968 M.P. 103, at p. 106 (para 6).
15. (1963) 47, I.T.R. 434,436 = I.L.R. (1962) 1 Ker.95.
16. (1965) 58 I.T.R. 302.
17. (1965) 58 I.T.R. 787.
18. (1962) 46 I.T.R. 1056.
19. A.I.R. 1959 Bom. 96.

of penal proceedings, that the burden of proof was upon the Income Tax Department and that the burden was not discharged by reason of the fact that the assessee gave a false explanation or plausible explanation in regard to the alleged concealed income or made a false statement in his return or failed to comply with the statutory obligations under the Act.

In M. Hussain Ali and Sons v. C.I.T., Madras[20] and Gnanmbika Mills Ltd. v. C.I.T., Madras[21] it was further stated that the findings in assessment proceedings were not conclusive in penalty proceedings. The assessment proceedings might be relevant or *prima facie* evidence for the imposition of penalty but the Department must prove beyond reasonable doubt that there had been a concealment of income.

Similarly, the Patna High Court in the case of C.I.T., Bihar and Orissa v. Mohan Mallah[22], Murlidhar Tejpal v. C.I.T., Patna[23] and Messrs. Khemraj Chagganlal v. C.I.T., Bihar and Orissa[24], held that the proceedings under section 28 of the Act of 1922 were penal proceedings and that the burden of proof lay upon the Income Tax Department that the assessee was guilty of concealment. It was further held that the unexplained increase in wealth and the plausible explanation of the source and nature of income do not mean

20. (1965) 58, I.T.R. 787.
21. (1965) 58, I.T.R. 802.
22. (1964) 54, I.T.R. 499 (Pat).
23. (1961) 42, I.T.R. 129 (Pat).
24. A.I.R. 1960 Pat. 252.

that the explanation was false or that the assessee was guilty of deliberate suppression of the particulars of his income.

The Gujarat High Court also expressed agreement with the Bombay High Court in C.I.T., Gujarat v. L.H. Vora[25].

The Calcutta High Court in C.I.T., Calcutta v. Anwar Ali[26] held that proceedings under section 28(1)(c) were criminal in nature. Basu J., delivering his judgement in the case said:

> "... T he 'additional tax' imposed by Sec. 28(1) is nothing but a punishment for a statutory offence and that instead of judicial punishment, the section prescribes for a penalty being awarded by the revenue authority."[27]

Another line of argument is that there is no essential difference between 'tax' and 'penalty', because the liability for payment of both is imposed as a part of the 'machinery of assessment' and the penalty is merely an additional tax imposed in certain circumstances for the defaults committed by the assessee.

The Allahabad High Court appears to be the champion for this proposition. The Court in Lal Chand Gopal Das v v. C.I.T., U.P.[28], laid down the following principles:

---

25. (1965) 56, I.T.R. 126 (Guj.).
26. A.I.R. 1968 Cal. 345.
27. Ibid at p. 352 (para 25).
28. (1965) 48 I.T.R. 324 (All), Dwarka Prasad Sheokaran Das v. C.I.T. (1953) 24 I.T.R. 410, see also A.V. Thomas and v. C.I.T., Madras I.L.R. (1967) 1 Mad. 255 at p. 267.

(i) A penalty proceeding under the Income Tax Act is not a criminal proceeding. Such proceedings are civil in nature and so the normal rules as to pleadings in civil cases will apply.

(ii) The onus of proof of non-concealment of income lies on the assessee. The Income Tax authorities are not required to place evidence to,prove any fact; what is required of them is that they must have materials to justify their finding of concealment or the particulars of income.

(iii) The findings in assessment proceedings that the assessee has concealed the particulars of income are sufficient to justify the finding of concealment for the purpose of imposition of penalty. Of course, the finding in the assessment proceedings is not *res judicata*[29] in the penalty proceedings and fresh evidence may be given by the assessee to show that he is not liable for penalty. The justification for the above proposition that penalty is an additional tax is found in certain observations of the Supreme Court of India made in *C.A. Abraham* v. *I.T.C., Kottayam*[30] and *C.I.T., Andhra Pradesh* v. *Messrs. Dadabhai and Company*[31].

---

29. *Messrs. Dwarka Prasad Sheokaran Das, Kanpur* v. *C.I.T.,U.P.* A.I.R. 1954 All 123; *Messrs. Kamlapat Motilal* v. *C.I.T., U.P.* A.I.R. 1950 All 249. The Code of Civil Procedure (5 of 1908) Sec. 11 deals with *res judicata*. It means a case or suit already decided.
30. A.I.R. 1961 S.C. 609.
31. A.I.R. 1961 S.C. 1265.

In C.A. Abraham v. I.T.O., Kottayam,[32] the appellant and one M.P. Thomas were carrying on a business in food grains in partnership. M.P. Thomas died on October 11, 1949. The appellant submitted, as a partner, returns of the income of the firm, which was unregistered. The Income Tax Officer discovered, in the course of assessment proceedings, that the firm had carried on transactions under different fictitious names and had not disclosed substantial sums of money earned.

The Income Tax Officer, therefore, assessed the suppressed income of the firm and imposed a penalty of Rs. 29,000 upon the firm under section 28 read with section 44 of the Act of 1922. The appellant contended that section 44 referred merely to the assessment of profits of tax and not to the levy of any penalty and that no order imposing a penalty could be imposed after the death of one of the partners[33]. The relevant portion of section 44[34], as it stood at the material time, ran as follows:

---

32. A.I.R. 1961 S.C. 609.
33. Mahakali Subbarao v. C.I.T. A.I.R. 1957 A.P. 113; In Veeraupan Chettiar v. C.I.T., Madras (1957) 32 I.T.R.,411, the Madras High Court held that section 44 (as it stood at the material time) referred merely to the assessment of profits to tax and not to the imposition of a penalty. The decision was overruled by the Supreme Court in C.A. Abraham v. C.I.T. A.I.R. 1961 S.C. 609.
34. Income Tax Act, 1961, sections 177 and 189 reproduce the provisions of section 44 of the Act of 1922.

"Where any business, profession or vocation carried on by a firm ... has been discontinued,... every person who was, at the time of such discontinuance or dissolution, a partner of such firm ..., shall, in respect of the income, profits and gains of the firm ..., be jointly and severally liable to assessment ... under Chapter IV and for the amount of tax payable... and all the provisions of Chapter IV shall, so far as may be, apply to any such assessment."

The Court rejected the appellant's contention and held that the legislature had expressly enacted that 'the provision of Chapter IV shall apply to the assessment of a business carried on by a firm even after discontinuance of its business; and that the process of assessment included steps for imposition of penalty[35]. The Court described 'penalty' as 'an additional tax' and observed:

"By S.28 [corresponding to section 271 of the Act of 1961] the liability to pay additional tax, which is designated 'penalty' is imposed in view of the dishonest or contumacious conduct of the assessee."[36]

Their Lordships refused to give a narrow meaning of the provisions of the impugned section and held that where the partners of the firm were guilty of conduct exposing them to penalty, by adopting the simple expedient of discontinuing the firm, the arms of the said section 44 were long enough to reach such cases and defeat such design. The Court declined to side with the assessee in his attempt to evade the penalty and said:

---

35. See C.I.T., Bihar and Orissa v. Messrs Kirkend Coal Co. A.I.R. 1969 S.C. 1352, at 1355 (para 9).
36. C.A. Abraham v. C.I.T., Kottayam A.I.R. 1961 S.C. 609 at p. 612, (para 5). The Supreme Court approved of the decision of Mareddi Krishna Reddy v. C.I.T., Tenali, A.I.R. 1957 A.P. 368.

> "... W here, as in the present case, by the use of the words capable of comprehensive import, provision is made for imposing liability for penalty upon the taxpayer guilty of fraud, gross negligence or contumacious conduct, an assumption that the words were used in a restricted sense, so as to defeat the avowed object of the legislature, quo a certain class, will not be lightly made."[37]

The other case is C.I.T., Andhra Pradesh v. Messrs. Bhikaji Dadabhai and Co.[38], in which the Supreme Court expressed agreement with its previous decision in C.A.Abraham v. C.I.T., Kottayam[39], that a penalty is an additional tax, imposed in view of the assessee's dishonest or contumacious conduct.

The assessee owned an oil mill in the former State of Hyderabad (now Andhra Pradesh). He returned an income of Rs.50,384 for the assessment year 1947 (October 1, 1946, to September 30, 1947). The Income Tax Officer, on examination, found the books of account unreliable and assessed the total income of the firm at Rs. 1,63,131. The Income Tax authorities, thereafter imposed a penalty of Rs.42,000 under section 40 of the Hyderabad Income Tax Act for concealment of income on October 31, 1951.

The State of Hyderabad merged with the Indian Union during the pendency of the proceedings. In 1950, the Hyderabad Income Tax Act was repealed by sub-section (1) of section 13 of the Finance Act, 1950, which provided that:

---

37. Ibid. at p. 612 (para 6).
38. A.I.R. 1961 S.C. 1265 at p. 1267 (para 9).
39. A.I.R. 1961 S.C. 609.

> "If immediately before the 1st day of April, 1950, there is in force in any part B State... any law relating to income tax or super-tax... that law shall cease to have effect except for the purposes of the levy, assessment and collection of income-tax and super-tax in respect of any period not included in the previous year for the purposes of assessment under the Indian Income-tax Act, 1922...."

The question was whether the power to impose a penalty in respect of the years,preceding the date of repeal was lost, because of the repeal of the Hyderabad Income Tax Act by the Finance Act, 1950. The assessee argued that the operation of the Hyderabad Act was saved only in respect of the levy, assessment and collection of income tax and super tax and not in respect of any 'penalty'.

The Court rejected the respondent's contention and held that a penalty is an additional tax and accordingly the proceedings for the imposition of penalties were saved by Sec. 13(1) of the F.A. Act, 1950. Their Lordships expressed the view that the High Court was in error in holding that by saving the Hyderabad Income Tax for the purposes of levy, assessment and collection of tax, the entire procedure for imposing liability to tax and for collection of tax was saved, but money payable under the penalty sections, not being tax,the provisions relating to the imposition of and collection of a penalty, did not survive the repeal of the Act. It was held that the imposition of a penalty was a necessary concomitant or incident of the process of assessment, levy and collection of tax.

An inference can also be drawn from the decision of the Supreme Court in Collector of Malabar v. Erimmal Ebrahim Hajee[40], that the nature of income tax penalties is not criminal.

The respondent had been arrested on 1st June, 1954, in pursuance of a warrant issued by the Collector of Malabar under section 48 Madras Revenue Recovery Act (2 of 1864) for failure to pay income tax,(including interest and penalty) as required under section 46 of the Income Tax Act, 1922.

The question for decision was whether the assessee was deprived of his personal liberty in accordance with a procedure established by law, or whether there had been a violation of the fundamental right in Article 21 of the Constitution.

It may be noted that the Income Tax Officer made independent inquiries which gave him reason to believe that the respondent was wilfully withholding payment of tax. Thereafter the Income Tax Officer issued a certificate under section 46(2) of the Income Tax Act, 1922, to the Collector to recover the arrears of tax. On this certificate the Collector proceeded under section 48 of the Madras Revenue Act and the respondent was arrested.

Their Lordships, rejecting the respondent's contention, held that, there was no deprivation of personal liberty such as to controvene Article 21 of the Constitution

---

40. A.I.R. 1957 S.C. 688.

in the case. The Court observed that:

> "In the present case, the arrest was not in accordance with any allegation or accusation of any actual or suspected or apprehended commission of any offence of a criminal or quasi-criminal nature. It was really an srrest for a civil debt, in the process or the mode prescribed by law for recovery of arrears of land revenue."[41]

The Court's statement makes it abundantly clear that sums due under the Income Tax are nothing but debts payable to the Government and so a penalty imposed is similar to the penalties imposed in civil cases.

It was thought, after the decision of the Supreme Court in C.A. Abraham's case, that the controversy in regard to the nature of penal proceedings amongst the various High Courts was dead and buried. But it proved otherwise. The Supreme Court itself, in its latest case, C.I.T., West Bengal v. Anwar Ali[42], showed a wavering attitude in regard to the nature of penal proceedings under the Income Tax Act. When the Court's attention was drawn at its earlier decision of C.A. Abraham on the nature of penal proceedings, their Lordships side-tracked the issue and made conflicting statements. The Court on the one hand admitted that:

---

41. Ibid. at p. 691 (para 10); see Purshottam Govindji Halai v. B.M. Desai A.I.R. 1956 S.C. 20. The assessee was arrested and detained in jail in execution of a warrant of arrest issued under section 13 of the Bombay City Land Revenue Act (1876). For recovery of the tax certified under section 46(2) of the Income Tax Act, 1922. It was held that the provisions did not infringe the Fundamental right guaranteed under Article 21 of the Constitution and so the arrest was in accordance with the procedure established by law.
42. A.I.R. 1970 S.C. 1782.

"...It is true that penalty proceedings under section 28 are included in the expression 'assessment' and the true nature of penalty has been held to be additional tax."[43]

Whereas on the other hand the Court said:

"...[I]n C.A. Abraham's case ... the observations made, with regard to penalty being an additional tax, were made in a different context and for a different purpose.[44]

Their Lordships said that it was settled that the nature of penalties under the Sales Tax Law was quasi-criminal[45], but refrained from expressing any opinion on the nature of penal proceedings under the Income Tax Act. The Court merely said:

"...The section [28] is penal in the sense that its consequences are intended to be an effective deterrent which will put a stop to practices, which the legislature considers to be against the public interest."[46]

It may be noted that the imposition of 'interest' for non-performance of the statutory obligations under the Income Tax Act, is also 'penal', in the sense that it is intended to put an effective check on the undesirable practice of the taxpayer. However, it is well recognized that, for the levy of 'interest', the law does not require a criminal standard

---

43. Ibid, at p.1784 (para 4). The Supreme Court in Messrs. Jain Brothers v. Union of India A.I.R. 1970 S.C. 778,784 (para 10), while upholding the constitutional validity of section 297(2)(g) of the Income Tax Act, 1961, acknowledged that:
"...[P]enalty has been regarded as an additional tax in a certain sense and for certain purposes under the Act...."
44. Ibid. at p. 1785. (para 4).
45. Hindustan Steel Ltd. v. State of Orissa A.I.R. 1970 S.C. 253.
46. A.I.R. 1970 S.C. 1782 at pp. 1784-1785.

of proof and the burden of proof that the fault was due to 'reasonable cause' lies on the taxpayer[47].

In regard to the evidence necessary for the imposition of a penalty, it was held in H.M. Istifa Khan v. C.I.T. C.P. and U.P., by the Oudh High Court as long ago as 1942 that:

> "... We see no reason why any distinction should be drawn between the quantum of evidence required to support the assessment and the quantum required to justify the imposition of a penalty."[48]

The Income Tax Officer issued a notice under section 34 of the Act of 1922 on the assessee in respect of the alleged concealment of interest on Rs. 4 lacs deposited in a bank in the joint names of himself and his minor son, Abdul Kasim. The Income Tax Officer did not accept the appellant's story that the money belonged to his five sons and not to himself.

The appellant's contention that the money was given by his wife to her five sons in 1919 at the time of her death and that the sum was deposited in the joint names of Abdul Kasim and his father, as a matter of convenience, and that Istifa Khan did not himself own any portion of it, was considered false, as the assessee failed to adduce any reason why, if it was left by his wife to her sons, it was entered in the name of one son only. Apart from this, the appellant did not produce any evidence to show what happened

---

47. See infra pp471/84 for burden of proof; see Chapter VI, pp. 279/79 for nature of 'interest' imposed under the Act.
48. (1942) 10 I.T.R. 435 at p. 439 (Oudh).

to the money between 1919, the date of the lady's death, and 1933, when it was deposited in the bank; this casts doubt on the veracity of the statement of the assessee. Accordingly, the Income Tax Officer assessed the income under section 34 and imposed a penalty of Rs.4,000 for concelament and deliberately furnishing inaccurate particulars of income, under section 28 of the Act.

The Court rejected the appellant's plea that for the purpose of proceedings under section 28 of the Income Tax Act, strong evidence should have been forthcoming. It was held that the Income Tax 'authorities' inference that 'Istifa Khan had concealed the fact that this money and the interest thereon belonged to him', was sufficient for imposition of penalty under section 28 of the Act.

A third line of approach is that penalty proceedings under the Income Tax Act are neither criminal nor civil in nature but quasi-criminal. The support for this contention is derived from the decision of the Calcutta High Court in C.I.T., West Bengal v. Anwar Ali[49], the Orissa High Court in Bhajuram Ganpat Ram v. C.I.T., Bihar and Orissa[50], and the very recent case in the Allahabad High Court, R. Prasad Mohonlal v. I.T.A. Tribunal[51].

Basu J., while delivering a separate judgement in C.I.T., West Bengal v. Anwar Ali, said:

---

49. A.I.R. 1968 Cal. 345.
50. A.I.R. 1970 Orissa 38.
51. A.I.R. 1970 All 620, at p. 630 (para 27(iii)). (F.B.).

> " ... [T]he proceeding for imposition of the penalty under sec. 28 (1) of the Income Tax Act cannot be regarded as a 'criminal proceeding', (however) there is no reason why it cannot be regarded by law as'quasi-criminal' in the sense that it would partake of some of the characteristics of a criminal proceeding, even though the punishment is not going to be awarded by a criminal court after a trial, and that is what is meant by a 'penal proceeding'. That follows from the essential characteristics of a statutory penalty viz., that it is intended to be punishment for the violation of a law."[52]

The Orissa High Court in Bhajuram Ganpatram v. C.I.T., Bihar and Orissa, allowing the appeal, said:

> " ... [T]hese penalty proceedings,under the Income Tax Act, are in the nature of quasi-criminal proceedings and the onus is on the Department to establish the necessary ingredients under section 28(1)(c)."[53]

The Income Tax Officer, while making the assessment of a Hindu Undivided family (of which Ganpatram was the *karta*) for the year 1953-54, added the sum of Rs. 20,000, which appeared in the cash book of the assessee.

The assessee's contention, that the sum belonged to the four ladies of the family, was rejected, as the *tippa book* (cash book) produced in support of the statement was held to be unreliable. Thereafter, the Income Tax Officer started proceedings under section 28(3) of the Income Tax Act, 1922, and imposed a penalty under section 28(1)(c) of the Act for concealment of income, which was upheld by the Appellate Assistant Commissioner and the Income Tax Tribunal.

---

52. A.I.R. 1968 Cal. 345, at p. 352 (para 27).
53. A.I.R. 1970 Orissa 38, at p. 40 (para 5).

The question for decision was whether the penalty could be imposed without further evidence to establish that there was concealment of income or that the assessee deliberately furnished inaccurate particulars of such income. The Court answered in the negative and said:

> "...Doubtless the decision in the assessment proceeding can be taken into consideration in the penalty proceeding; but by itself it would not be enough to establish the necessary ingredients. Other evidence de hors the conclusion made in the assessment proceeding would be relevant and admissible.... In the assessment proceedings the assessee might have failed to prove his case that the questioned income is not his, but that will not prove the contrary, namely, that it has been established by the department that such income is concealed income. Different conclusions emerge, when the onus is placed either on the assessee or on the department to establish that the income had been concealed. Failure on the part of the assessee to prove his own case does not mean that the department succeeds in establishing its case that there was concealment of income..."[54]

The Madras High Court in Gnanmbika Mills Ltd. v. C.I.T., Madras[55], held that the degree of proof required for the imposition of a penalty is not that of criminal proceedings in the strict sense of the term. The appellant company, which was engaged in the manufacture and sale of yarn, sold certain bales of yarn at the prevailing market rate and earned a huge profit. However, the company showed less than the income earned in the return for the assessment year 1949-50.

---

54. Ibid. at p.40 (para 5).
55. I.L.R. (1966) 2 Mad. 491.

The company alleged that it had sold the yarn to its employees and certain villagers, at a considerably lower rate (i.e. at the rate fixed by the Mill Owners Association). The Company stated that it made this gesture, because its employees and villagers had been helpful to the management during the strike a few months earlier. The Income Tax Officer, while making the assessment,on investigation came to the conclusion on materials available, that the assessee's explanation was unacceptable. The alleged sale to employees and villagers was not proved; the sales were made directly to certain dealers at the market rate which was much higher than the rate stated. The Income Tax Officer instituted penalty proceedings under section 28(1)(c) of the Act and imposed a sum of Rs. 32,000 as penalty for concealment of particulars of income.

The assessee contended that the ground in the assessment proceedings for holding that the profits were greater than those stated by the assessee were not a sufficient basis for computing a penalty, but a higher degree of proof is required of concealment and that the concealment of the particulars of income should be proved beyond reasonable doubt.

The Court rejected the appellant's claim and held that the Income Tax Officer was justified in finding that the sales to labourers, as alleged by the assessee, were make-believe, intended to circumvent the circular issued by the South Indian Mill Owner's Association, directing its members to sell yarn at the association's rate, and to secrete the surplus amount realised from the ultimate purchasers, without bringing them into the books of account, so that section 28 applied. As regards the burden of proof, the Court relied on the statement of Lord Denning in Miller v. Minister of Pensions[56], that 'proof beyond doubt' does not mean 'proof beyond a shadow of doubt'. The Court said:

> "... [P]roof beyond reasonable doubt means that there must be a high degree of probability than what is implied in the discharge of the burden of an issue in a civil case... While in a civil case a reasonable degree of probability may support a decision, a higher degree of probability is required in a criminal case.[57]

Similarly, in P.K. Kalasami Nadar v. C.I.T., Madras, the learned judge of the Madras High Court stated:

> "... Treating the penalty proceedings under the Indian Income Tax Act as being more in the nature of criminal proceedings than civil proceedings, we can say that the facts must establish a high degree of probability of the assessee being guilty of the charge against him and nothing more, and, of course, nothing less. Imaginary possibilities ought not to be assumed to weaken the conclusion which is the result of a fair inference from the materials on record. Any rigid standard of proof in these matters cannot be laid down and we are hesitant to embark on such a venture."[58]

The supporters of this view further lean on the latest case of the Supreme Court, Hindustan Steel Ltd. v.

---

56. (1947) 2 All E.R. 372, 373.
57. I.L.R. (1966) 2 Mad. 491 at p. 495.
58. (1962) 46 I.T.R. 1056, 1063.

State of Orissa[59], in which the Court held that penal proceedings under the sales tax law are quasi-criminal in nature. It is said that the Income Tax Act, being also revenue legislation is akin to sale tax in nature.

It may be appropriate to examine in this connection, the nature of the penalty imposed by the Revenue authorities in some of the major Commonwealth countries, viz., the United Kingdom, Canada, Australia, New Zealand, and in the United States of America.

The Position in Other Countries

The position in the United Kingdom appears to be well estabished that penal proceedings are civil in nature. This is the logical inference of the following statement made in the Halsbury's Laws of England:

> "Proceedings for the recovery of penalties are not criminal proceedings[60]; nor it seems, are they proceedings in tort."[61]

The proposition that such penalties are civil in nature has been approved by the Court of Appeal in C.I.R. v. Jackson[62]. The action was to recover penalties under section 232 of the Income Tax Act, 1952 (now repealed). The taxpayer failed to submit particulars of his income for

59. A.I.R. 1970 SC 253,256 (para 7).
60. R. v. Hausmann (1909), 73 J.P. 516 (C.C.A.); Attorney-General v. James Casey (1930) I.R. 163; C.I.R. v. Jackson (1960) 39 T.C. 357,358.
61. (1957), Simond's Edition, Vol. 20, section 1447, at p. 719. A.G. v. Canter, (1939) 1 K.B. 318.
62. (1960) 39 T.C. 357.

certain years within a specified time, as required by a notice issued by the Commissioner of Taxes. Thereupon the Commissioner levied the penalty under section 232[63] of the Income Tax Act, 1952, for failure to submit the particulars without reasonable cause. The defendant denied the allegation and pleaded not guilty.

The Court rejected the appellant's contention that the proceedings, being 'criminal proceedings', he could not be required to give the particulars of his income. It was held that, though the Commissioner's claim was one for a penalty, it was not a 'criminal proceeding' and the normal rules as to pleadings in a civil action would apply. Sellers, L.J., while delivering the judgement of the Court, said:

---

63. The British Income Tax Act, 1952 (c 10), section 232 which dealt with the delivery of additional particulars for purposes of sur-tax, provided that:
"(1) The Special Commissioners may, ... require any individual who-
(a) has been required to make a return of his total income for the purposes of sur-tax; or
(b) being an individual liable to sur-tax, has been required to make a return of his income...,

to furnish to them within such time as they may prescribe, ... such particulars as to the several sources of his income and the amount arising from each source, and as to the nature and amount of any deductions claimed to be allowed therefrom, as they consider necessary.

(2) If any person without reasonable cause fails to furnish within the time prescribed any particulars required ..., he shall be liable to a penalty not exceeding fifty pounds, and, ... to a further penalty of the like amount for every day during which the failure continues."

"...One can simply take this case as a claim for penalties. It is not a criminal proceeding. The form of the pleading is of the usual kind and normal, so far as particulars are required, of the averments in the pleading."[64]

The civil nature of penalties is further illustrated by the fact that the penalty survives the taxpayer's death.

The Court of Appeal in Attorney-General v. Canter[65], upheld the claim of the Revenue to realize penalties under section 30(1)(b) of the repealed Income Tax Act of 1918[66], from the deceased's executrix, in respect of incorrect statements made by the deceased in his income tax returns for the year ending April 5, 1932 and April 5, 1933. No proceedings were taken against the taxpayer during his lifetime, but proceedings were commenced against his executrix on July 26, 1937.

---

64. (1960) 39 T.C. 357, at p. 358.
65. (1939) 1 All E.R. 13.
66. The British Income Tax Act, 1918 (CH 40), section 30 (1)(b), provided that:
"30(1). A person who in making a claim for or obtaining any exemption, abatement, or relief ... , or in obtaining any certification as aforesaid -
...
(b) fraudulently conceals or untruly declares any income or any sums which he has charged against or deducted from, or was entitled to charge against or to deduct from another person;
...
shall forfeit the sum of twenty pounds and treble the tax chargeable in respect of all the sources of his income.

The question was whether the 'cause of action' in such a case by virtue of the Law Reform (miscellaneous Provisions) Act, 1934, section 1(1) would survive against the estate of the deceased. The Act of 1934 was enacted "to amend the law as to the effect of death in relation to causes of action and as to awarding of interest in civil proceedings..." The object of the Act is commonly said to be to abolish the doctrine of <u>actio personalis moritur cum persona</u>[67]. Section 1(1) of the Act provided that:

> "...[O]n the death of any person... all causes of action subsisting against or vested in him shall survive against, or, as the case may be, for the benefit of his estate."

The respondent argued that the Act of 1934 had no operation with regard to any penalty imposed by the Income Tax Acts, and, in particular under section 30, the reason being that such penalties were quasi-criminal in nature[68].

The Court repudiated the respondent's claim and gave a wider meaning of the expression 'cause of action' in section 1(1) of the Act so as to include cases in respect

---

67. <u>Ross</u> v. <u>Ford</u> (1937) 3 All E.R. 359 at p. 367.
68. <u>Huntington</u> v. <u>Attrill</u> (1893) A.C. 150. Lord Watson pointed out in delivering the judgement of the Privy Council at p. 156, that:

> "...[T]he word 'penal' may embrace penalties for infraction of the general law which do not constitute offences against the State; it may for many [sic] legal purposes, be applied with perfect propriety to penalties created by contract, and it therefore, when taken by itself, fails to mark that distinction between civil rights and criminal wrongs..."

of penalties under the Income Tax Act, in particular in section 30. It was held that the 'cause of action'; although belonging to the special class created by the Income Tax Act, was within the scope of the expression 'all causes of action' in sub-section (1) of section (1) of the Act of 1934, and survived against the estate of the deceased.

The situation in Canada is simlar to that in the United Kingdom.

The Court of Exchequer in Alex Pashovitz v. Minister of National Revenue[69], in an appeal from an assessment of penalties made by the Minister[70], held that the nature of such penalties was a civil matter. The facts of the case are as follows:-

The appellant, a farmer with little knowledge of accounting, made incorrect income tax returns for several taxation years. The Minister, following an investigation, came to the conclusion that the appellant had not reported certain income from the operations of a partnership with his father and disallowed certain expenses claimed as deductions. Thereafter the Minister assessed tax and penalties under section 51A of the Income Tax Act, which provided that:

69. (1961) Ex C.R. 365 (Canada).
70. The Income Tax Act, 1948, section 42 authorized the Minister to make assessment of penalties under certain circumstances. The present Income Tax Act of 1952 contains similar provision in section 46.

"Every person who has wilfully, in any manner, evaded or attempted to evade payment of the tax payable by him... for a taxation year or any part thereof is liable to a penalty, to be fined by the Minister, of not less than 25% and not more than 50% of the amount of the tax sought to be avoided."[71]

The Court repudiated the taxpayer's claim that, as penalties were criminal punishment, the burden of proof lay upon the Minister. Thurlow, J., holding the taxpayer liable as he failed to prove that the assessment of the penalty was wrong, said:

"The proceedings are, however, of a civil nature, and a preponderance of evidence is sufficient."[72]

In another case, Minister of National Revenue v. Maurice Taylor[73], the question arose as to the standard of proof required in case of penalties imposed by the Minister of Revenue for fraud or misrepresentation made by the taxpayer. The Minister appealed from a decision of the Tax Appeal Board, which allowed the respondent's appeal from reassessments made upon him for the taxation years 1948 and 1949.

The respondent was assessed to income tax in the usual way on his income for the years 1948 and 1949. The Minister of National Revenue found afterwards that the taxpayer had committed fraud in making his returns for the said years. The Minister discovered that the taxpayer had failed to report all his bond interest, had ommitted certain assets from the financial statement attached to the return and had made a gift of $11,000 to his wife in one of the years

71. Income Tax Act, 1952, section 56(1) is the corresponding section which is applicable now.
72. (1961) E.C.R. 365 at p. 372. (Canada).
73. (1961) 61 D.T.C. 1139 (Canada).

under appeal and failed to mention it in the return. Thereupon the Minister made reassessments of the taxpayer's income, relying on section 55[74] of the Income Tax Act, 1917, and section 42(4)[75] of the Income Tax Act, 1948, for the years 1948 and 1949 respectively.

The taxpayer objected to the reassessment on the ground that the Minister had not established misrepresentation or fraud beyond a reasonable doubt so as to justify the reassessments. While repelling the respondent's contention, the Court said:

> ",..[T]he standard to be applied is not that applicable in criminal proceedings, namely, proof beyond reasonable doubt, but that applicable in civil proceedings, namely, the standard of balance of

---

74. Income War Tax Act, 1917 (Can. Ch.28), section 55 provided that:

    "Notwithstanding any prior assessment, or if no assessment has been made, the taxpayer shall continue to be liable for any tax and to be assessed thereof and the Minister may at any time assess any person for tax, interest and penalty and may

    (a) at any time, if the taxpayer has made any misrepresentation or committed any fraud in making his return or supplying information under this Act,...
    ...
    re-assess or make additional assessments upon any person for tax, interest and penalties."

75. Income Tax Act, 1948, Section 42(4) provided that:

    "The Minister may at any time assess tax, interest or penalties and may

    (a) at any time if the taxpayer or person filing the return has made any misrepresentation or committed any fraud in filing the return or supplying information ...
    ...
    reassess or make additional assessments."

probability."[76]

In Australia, unlike the United Kingdom and Canada the Legislature has made it clear that the Income Tax penalties are civil in nature. Section 237 of Part VII of the Income Tax and Contribution Assessment Act, 1936-1970[77], which deals with penal provisions and prosecutions, expressly provides that:

> "Every taxation prosecution ... may be commenced, prosecuted and proceeded with in accordance with... the usual practice and procedure of the court in civil cases..."

This has practically left no scope for judicial interpretation and the Courts have approved the legislative scheme. For instance in Jackson (Federal Commissioner of Taxation) v. Butterworth, Fullagar J., (while delivering the judgement of the Supreme Court of Victoria), with regard to the question whether taxation proceedings under Part VII, of the Act was a civil proceeding or a criminal proceeding, said:

> "... [T]he proceeding is civil and not criminal in character. The procedure is by action to recover a penalty, and the rules of civil procedure

---

76. (1961) 61 D.T.C. 1139 at p. 1141. The Court referred to various authorities on the subject, viz., Halsbury's Laws of England, Third Ed. Vol. 26, p. 845; Hornal v. Neuberger Products Ltd. (1956) 3 All E.R. 970; Amis v. Colls (1960) T.R. 213.
77. The Act provides provisions relating to imposition of penalties (i) for failure to furnish a return, (ii) for making false statements, (iii) fraudulent avoidance of tax and so on. See Gunn's Commonwealth Income Tax Law and Practice, 6th ed. (1960), (Butterworths), p. 1428.

apply."[78]

Similarly, in regard to the degree of proof required for a taxation proceeding, William J., in McGovern v. Hillman Tobacco Company, after citing section 237 of the Act, said:

> "The standard of proof is... the standard of proof required in civil cases."[79]

Thus it becomes evident that the specially heavy burden imposed on the State in criminal cases is not borne by the Revenue in taxation proceedings. Of course, the Court must be well satisfied, after examining the evidence on the record before it arrived at the conclusion that the defendant has committed a default which would attract a penalty[80].

New Zealand, like its neighbour Australia appears to have thought it desirable to define the nature of penal tax, instead of leaving it for the courts to guess it. The Land and Income Tax Act, 1954, in section 232 states that:

> "...[P]enal tax shall for all purposes be deemed to be tax of the same nature as the deficient tax, and shall be deemed to be payable in and for the same year of assessment as the deficient tax."

---

78. (1949) 8 A.T.D. 214, at p. 216; Jackson v. Gromann (1948) V.L.R. 408, 411. In A.G. v. Freer (1822) 11 Price 183, at p. 197, the Court expressed the view as long ago as 1822, that penalties were for many purposes civil in nature; Naismith v. McGovern (1953) 90 C.L.R.336; However in Mallan v. Lee (1949), 80 C.L.R. 198, the Full Court refrained from saying anything decisive on the point In Re Curtis (1951), 15 A.B.C. 172, a sales tax prosecution was held to be a civil proceeding;
79. (1949) 4 A.I.T.R. 272, at p. 275; R. and Federal Commissioner of Taxation v. McStay (1945), 3 A.I.T.R. 209.
80. 'Income Tax Law and Practice' (Commonwealth), Challoner and Greenwood, (1962 with Supplement 1969), 2nd ed. at p.1156 (para 1625).

It is therefore obvious that the nature of penal proceedings is civil.

The Courts have not questioned its propriety; they have decided cases bearing this fact in mind. For instance, it was held by the Supreme Court at Wellington in Taylor v. Attorney-General[81] that acquittal of a taxpayer on a charge of wilfully making a false return of income under section 228(1)(b)[82], does not stop the Commissioner of Inland Revenue from imposing on the taxpayer a penal tax under section 231 of the Land and Income Tax Act, 1954.

The taxpayer was charged under section 228(1)(b) of the Act with having wilfully made false returns of income for the years 1954, 1955 and 1956, but the taxpayer was acquitted of the charge by the Magistrate. Thereupon, the Commissioner of Inland Revenue imposed penal taxes to the extent of £150, £50 and £100 respectively under section 231 in respect of each of such years. Section 231 states that:

> "If any taxpayer evades, or attempts to evade, or does any act with intent to evade, or makes default in the performance of any duty imposed ... with intent to evade, the assessment or payment of any sum... chargeable against him by way of tax ... he shall be chargeable, by way of penalty for that offence, with additional tax (hereinafter called penal tax) not exceeding an amount equal to treble the amount of the deficient tax."

---

81. (1963) N.Z.L.R. 261.
82. Land and Income Tax Act, 1954, section 228(1)(b) provides that:
"Every person commits an offence against this Act who -
...
(b) Wilfully or negligently makes any false return, or gives any false information, or misleads, or attempts to mislead the Commissioner or any other Officer, in relation to any matter or thing affecting his own or any other person's liability to taxation.".

The taxpayer argued that the first judgement operated res judicata, and that the acquittal of the first charge bars an action on the second charge of evading tax. The Court repudiated the assessee's claim and held that it did not operate as res judicata, because the former charge was in relation to a criminal offence while the latter with regard to civil penalties and therefore the issues were different. The Court said:

> "...It is necessary for this submission to succeed that the issue of evasion, made a pre-requisite to enable charge of penal tax (s.231), be identical with the issue of wilfully making a false return (s.228(1)(b) in respect of which offence the plaintiff was acquitted."[83]

Similarly, it was held in Maxwell v. Commissioner of Inland Revenue[84] that the acquittal of a taxpayer on a charge of wilfully making a false return under section 228(1)(b) did not bar the right of the Commissioner to form the opinion that the return so made was fraudulent or wilfully misleading and to make a reassessment of income under section 24[85] of the Income Tax Act, 1954. As regards the

---

83. Taylor v. Attorney General (1963) N.Z.L.R. 261,262.
84. (1962) N.Z.L.R. 683.
85. The Land and Income Tax Act, 1954, section 24, provides a period of limitation for amendment of an assessment. The section as stood at the relevant time reads as follows: "Where any person has made returns and has been assessed for land tax or income tax for any year, it shall not be lawful for the Commissioner to alter the assessment so as to increase the amount thereof after the expiration of four years from the end of the year in which the assessment was made;or in any case where, in the opinion of the Commissioner, the returns so made are fraudulent or wilfully misleading or, in the case of returns of income omit all mention of income which is of a particular nature or was derived from a particular source and in respect of which a return is required to be made after the expiration of 10 years from the end of the year in which the assessment was made."

appellant's contention that an acquittal on a prosecution could be relied upon as a ground of estoppel in subsequent proceedings, the Court said that the issues in criminal and civil proceedings being different the doctrine of estoppel will not apply. North, J., of the Court of Appeal said:

> "...In the criminal proceedings, the Commissioner was required to prove that the appellant had made fraudulent returns. In the civil proceedings at best, all he would be averring was that he was still honestly of opinion that the returns were fraudulent."[86]

In the United States of America there appears to be no controversy in regard to the nature of the additional tax[87] imposed to discourage fraudulent attempts to evade tax. The rival contentions of taxpayers that such penalties are criminal and of the Inland Revenue that they are civil in nature seems to have been laid at rest by the Supreme Court in Guy T. Helvering v. Charles E. Mitchell[88] in favour of the latter. This is the logical implication of the Supreme Court's holding that the constitutional prohibition against double jeopardy did not preclude the imposition of a civil penalty for tax fraud despite acquittal of a taxpayer on a criminal charge[89].

---

86. (1962) N.Z.L.R. 683, at p. 703.
87. The Internal Revenue Code, 1954, provides two types of sanction to combat tax evasion, viz., (1) Additions to the tax and (2) Criminal penalties. These are contained in Chapter 68: Additions to the tax, and Chapter 75: Crimes, other Offences and Forfeiture.
88. (1937) 303 U.S. 391; Spies v. U.S., (1942) 317 U.S. 492
89. 'Income-Tax Fraud - Basic Principles for The General Practitioner', Francis J. Butler, (1958) 37, Or. L.R. 199 at p. 201.

The respondent taxpayer submitted a return of his income for the year 1929. The Commissioner of Inland Revenue found on investigation that the taxpayer had fraudulently deducted a substantial sum of money from his return of income, alleging a loss on a purported sale of shares and that he dishonestly failed to return a large sum of money and that these fraudulent acts were done with intent to evade tax. The Commissioner of Inland Revenue, therefore, imposed an additional tax of 50 per cent under section 293(b)[90] of the Code for fraudulent under-payment of tax and instituted criminal proceedings under section 46(b)[91] of the Internal Revenue Code 1928 for fraudulent evasion of tax. The taxpayer, was, however, acquitted on the criminal charge.

The respondent contended thereafter that the claim for 50 per cent additional tax was barred by the doctrine of <u>res judicata</u>, that the acquittal was a bar to further proceedings based on the same facts. It was further pleaded

---

90. Internal Revenue Code 1928, section 239(b) provided that: "If any part of any deficiency is due to fraud with intent to evade tax, then 50 per centum of the total amount of the deficiency (in addition to such deficiency) shall be so assessed, collected and paid..."
91. Internal Revenue Code, 1928, section 46(b) provided that; "Any person.. who wilfully attempts in any manner to evade or defeat any tax imposed... or the payment thereof, shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, be fined not more than $10,000, or imprisonment for not more than 5 years, or both, together with the costs of prosecution."

on behalf of the taxpayer that, both the proceedings being criminal, the second trial was against the doctrine of double jeopardy[92].

The Court upheld the Commissioner's claim for additional tax and rejected the respondent's contentions. It was held that the doctrine of estoppel by judgement[93] would not apply in the case, because the proceedings to determine the amount of additional tax was different in nature from the indictment of wilfully attempting to evade the tax. The former were civil proceedings and the latter criminal proceedings. The Court said:

> "The difference in degree of the burden of proof in criminal and civil cases precludes application of the doctrine of <u>res judicata</u>. The acquittal was 'merely... an adjudication that the proof was not sufficient to overcome all reasonable doubt of the guilt of the accused'... That acquittal on a criminal charge is not a bar to a civil action by the Government, remedial in its nature, arising out of the same facts on which the criminal proceedings were based..."[94]

As regards the respondent's second contention, the Court said that the provisions for imposition of additional tax and criminal penalty in respect of the same act or ommision did not violate the double jeopardy clause. The double jeopardy clause merely prohibits punishing twice, or

---

92. See infra note 10 for <u>double jeopardy</u>.
93. See '<u>Collateral Estoppel in Tax Fraud Proceedings</u>', J.R. Mentz (1965) 51 Virginia L. Rev. 1360 to 1378; '<u>Collateral Estoppel by Judgement</u>', Austin Wakeman Scott (1942) 56 Harv. L.R. 1; '<u>Collateral Estoppel Applied to Civil Fraud Penalty</u>', Buchwald, (1965) 19 U. Miami L.R. 672.
94. (1937) 303 U.S. 391 at p. 297. <u>Lewis</u> v. <u>Frick</u> (1913) 233 U.S. p. 291, 302.

attempting to punish a second time criminally for the same offence. The additional tax, being remedial in character, is not a penalty in the criminal sense. The Court stated:

> "... The [additional taxes] are provided primarily as a safeguard for the protection of the revenue and to reimburse the Government for the heavy expense of investigation and the loss resulting from the taxpayer's fraud."[95]

The civil nature of a penalty is also exemplified from the fact that fraud penalties can be realized from the deceased's estate.

In Francis P. Kirk v. Commissioner of Inland Revenue[96], the U.S. Court of Appeal, first circuit upheld the claim of the revenue to charge a fraud penalty against a taxpayer's estate. The petitioner's decedent, who died on April 5, 1943, filed income tax returns for the years 1936 to 1942, in which he had fraudulently under-estimated his income with intent to evade the tax thereon. The Commissioner discovered the fraud after the decedent's death, and, in consequence, determined the deficiences against his estate for the above years and levied 50 per cent additional tax for each year under section 293(b) of the Internal Revenue Code, 1928.

The Court rejected the appellant's contention that the fraud penalty was intended by the Congress as a personal

---

95. Ibid at p.401; Stone v. U.S. 1922 167 U.S. 178, 188; Murphy v. U.S. (1926) 272 U.S. 630, 632. Hanby v. C.I.R. (1934) 67 F(2d) 125.
96. (1951) 15 A.L.R. (2d) 1031 (C.A.I.).

punishment for the taxpayer's fraud on the revenue, which died with the assessee. The Court, referring to *Mitchell's*[97] case, stated that a fraud penalty, being remedial in nature rather than punitive, is akin to compensation awarded in tort, so the modern rule, that a tort action survives against a decedent's estate, would apply. The Court stated:

> "... [A]ctions to recompense or compensate a plaintiff for a harm inflicted upon him by a decedent do survive, for an estate can, and we think should, compensate for an injury to same extent as the decedent, had he lived."

Thus the fraud penalty survives the taxpayer and could be realized from the estate of the deceased.[98] In a number of cases the Courts have affirmed that fraud penalties are civil in nature and have decided issues accordingly.[99]

Penalty Proceedings: Civil in Nature.

From the foregoing discussions it becomes evident that in the United Kingdom, Canada, Australia, New Zealand and the United States a distinction has been drawn in

---

97. (1937) 303 U.S. 391.
98. (1951) 15 A.L.R. (2d) 1031 at p. 1035 (C.A.I. See '*Tax Fraud and Evasion*', H.G. Balter, 3rd ed., (1963), section 8 3-9.
99. *Kann* v. *C.I.R.* (1934) 210 F(2d) 247 (3rd C.A.). The Court held a wife responsible for penalties levied as a result of her husband's fraud. It was held that the fact that she had neither signed the return nor authorized her husband to sign it on her behalf will not exempt her from civil liabilities incurred under the Code. In *Howell* v. *C.I.R.* (1949) 175 F(2d) (C.C.A.6) 240. It was held that the 50 per cent penalty assessed on a taxpayer for deficiences due to fraud with intent to evade income tax is a 'civil penalty', and may be imposed without regard to whether there had been a conviction on a criminal charge based thereon.

regard to the nature of penalties levied by the Revenue authorities and the Criminal Courts. However, in India the position still appears to be uncertain. Neither the legislature nor the judiciary has given a clear decision on the issue. Nevertheless, the inference can be drawn from the following propositions that administrative penalties are civil in nature and not criminal or quasi-criminal[1].

The very fact that the legislature has provided two separate chapters, 21 and 22, one dealing with penalties and other dealing with 'offences and prosecution' go to prove that different standards of proof and evidence are contemplated by the legislature[2]. This is further confirmed by the Explanation clause added to section 271(1)(c) of the Act of 1961, which places the burden of proof in certain cases of concealment and furnishing of inaccurate particulars on the assessee[3].

---

1. See '<u>The Struggle Against Tax Evasion; The Situation in Denmark</u>', S. Hirot Lorenzen (1953) 7, Bulletin for International Documents, p.8. The author has stated that 'fiscal fraud, deliberate or by gross negligence, is a delict <u>sui generis</u>', which cannot be classified under or parallel to ordinary crimes. (p.14).
2. Satish Chandra J., while delivering minority judgement in <u>R. Prasad Mohanlal</u> v. <u>Income Tax Appellate Tribunal</u> A.I.R. 1970 All 620 at pp. 635,636 states:
   "The authorities impose penalty if they are satisfied that a default has been committed. The revenue does not have to prove its case beyond all reasonable doubt. In prosecution under chapter XXII the Revenue will have to prove its case beyond all reasonable doubt, because it is a fundamental principle prevailing in the criminal courts."
3. See Chapter 6, p.313 for the text of the Explanation clause.

It has been clearly laid down by the Madras High Court in Sivagamintha Moopanar and Sons v. L.T.O., Madurai[4] that the two sets of penalties provided under the Income Tax Act are mutually exclusive in their nature and are directed to different objectives. For instance, the penalties provided under chapter 22[5] are enacted to vindicate public justice and to punish the offender for the deliberate infraction of the law, whereas the penalties contained in chapter 21[6] are enacted to render evasion unprofitable, and to secure for the State compensation for damages caused by attempted evasion.

The Rajasthan High Court appears to be more specific in its views on the matter and states in Messrs. M.P. Indra and Company v. Union of India that:

> "...[P]enalties prescribed under the Income Tax Act for failure to submit returns of income in time are not in the nature of punishment imposed for conviction of an offence. Such penalties are more or less compensatory in character to make good the loss that may be caused to the State revenue on account of late submission of returns of income and in consequence late realization of the tax. Therefore, the provisions relating to imposition of penalties can be said to form integral

---

4. (1955) 28 I.T.R. 601 (Mad.); Ratnaprova Devi v. State of Orissa A.I.R. 1964 S.C. 1195; Messrs M.P. Indra v. Union of India. A.I.R. 1965 Raj. 104, 106; Madula Appa Rao v. I.T.O. A.I.R. 1959 A.P. 391, 393.
5. See Chapter 7 for provisions relating to 'Offences and Prosecution'.
6. See Chapter 6 for provisions relating to administrative penalties.

parts of the proceedings relating to assessment."[7]

In a recent case from Allahabad High Court R. Prasad Mohanlal v. Income Tax Appellate Tribunal, Satish Chandra J. is more explicit on the point when he states:

> "...[P]rosecutions under Chapter XXII are criminal proceedings, but penalty proceedings under Chapter XXI constitute a civil sanction."[8]

It is perhaps because of all these considerations that the legislature provided in the Act of 1961 that both a penalty under Chapter 21 and a prosecution under Chapter 22 may be launched against an assessee on the same facts[9]. This will not violate the immunity granted to an accused against double jeopardy[10] under Article 20(2) of the Constitution.

---

7. A.I.R. 1965 Raj. 104 at p. 107 (para 10).
8. A.I.R. 1970 All 620, p. 636 (Minority judgement). (F.B.).
9. There was no such provision in the earlier Acts; section 28(4) of the I.T.A., 1922 prohibited Criminal and penal proceedings simultaneously.
10. 'The Republic of India', Alan Gledhill, (2nd. ed. Stevens and Sons, London, 1964), p. 198; 'Constitutional Protection of Life and Liberty', Alan Gledhill. (Studies in Law: Patna Law College Golden Jubilee Commemoration Volume, 1961) pp. 133,134. 'Life and Liberty in India', Alan Gledhill (1959-60) 2 J.I.L.I. 241, 247-248. See 'Right of Federal Government to Appeal, Adverse Criminal Decisions; The Supreme Court, 1969 Term,(1970) Harv. L.R. 133. 'Double Jeopardy' is based on the ancient maxim: nemo debit bis vexari pro eadem causa, no person shall be twice disturbed for the same cause. In other words no person can be punished and prosecuted for the same offence more than once. Protection is only given when there has previously been prosecution and punishment for the same offence before a Court of law. Thomas Dana v. State of Punjab, A.I.R. 1959 S.C. 375; 'A.I.R. Commentaries: Criminal Procedure (5 of 1898), 5th ed., Vol. III, Sec. 403, Note 1, Halkori Ram v. King Emperor (1941) 9 I.T.R. 209 (Pat); Minister of National Revenue v. Durocher (1952) 101 Can. Cri. Cas.245(Ex.C); T.S. Baliah v. T.S. Panachari, I.T.O., Madras A.I.R. 1969 S.C. 701,704; Helvering v. Mitchell (1937) 303 U.S. 391, 406; Spies v.

(continued on next page)

It is an accepted principle of criminal law that penalties being punitive in nature do not survive the deceased, for the reason that a deceased person is beyond punishment. But penalty levied under the Income Tax Act can be recovered from the estate of the deceased. As in case of torts, an action to compensate a plaintiff for harm done to him by a deceased survives and damages can be realized from the deceased's estate. It is on this assumption that the Act of 1961 has provided under section 159[11] that penalty proceedings for a default committed by a deceased can be started or continued against the legal representative in respect of tax, interest or penalty.

The usual mode of punishment in the case of criminal offences is imprisonment, or a fine with imprisonment in default; but it is not so in the case of penalties imposed by the administrative authorities.

The procedure for recovery of tax, interest and penalty[12] is different from that provided for the recovery of a penalty in criminal proceedings. The Supreme Court in Collector of Malabar and another v. Erimmal Ebrahim

---

10. (continued from previous page) U.S. (1943) 317 U.S. 493, 500. San Simon v. C.I.R. (1958)(C.A.8) 248 F(2d), 869; R v. Smith (1959) 120 Can.Cr. Case 241 (Ontario H.C.); Winston M. Reynold v. U.S. (1961),(C.A.5) 28 F(2d), 78. 'Criminal Law: Former Jeopardy: Conviction for False Return of of Income No Bar to Civil Action for Penalty'(1934), 47 Har. 1438, Olshausen v. C.I.R.(1960)(U.S. C.A.9), 273 F(2d) 23; N.A.Malbari v. C.I.T.,Bombay,A.I.R. 1964 S.C. 1807; Chaturbhuj and Company v. C.I.T.(1959) 36 I.T.R. 386 All
11. 'The Law and Practice of Income Tax', J.B. Kanga and N.A. Palkhiwala (1969), 6th ed. Vol.I at p.816.
12. See Chapter 2, pp. 47-49 for procedure for collection and recovery of taxes.

Hajee[13] has described the procedure for recovery of penalty under the Income Tax Act as the procedure for the recovery of a civil debt[14]. This obviously means that such proceedings are civil in nature.

The penalty does not carry with it the stigma attached to a criminal case. Thus a taxpayer, who is penalized for defaults committed under the Income Tax Act is not subject to disabilities which an accused carries in criminal cases.

Under the circumstances, to hold such penalties punitive in nature would cast serious constitutional doubts upon the administrative application of the penal provision of the revenue.

However, the Judiciary has failed to lay down authoritatively the distinction between the administrative and criminal penalties. The legislature could make the position clear in order to avoid undue complexity and inconvenience. This can be simply done by adding a section in Chapter 21, dealing with penalties, similar to that contained in section 237 of the Australian Income Tax and the Contribution Assessment Act 1936-1969[15]. This will make it clear that administrative penalties are civil in nature and forstall unnecessary controversy on the subject. A

---

13. A.I.R. 1957 S.C. 688.
14. Ibid. at p. 691 (para 10).
15. See supra p.457 for text of section 237.

somewhat similar suggestion has been made by Shri S. Bhoothalingham in his report on 'Rationalization and Simplification of Tax Structure'. He said that penalties should be dealt with by the Income Tax Authorities simultaneously with tax assessment and not separately, as at present[16]. This obviously would mean that such penalties would be treated as civil proceedings like the assessment proceedings. But his recommendation that the penalties for 'concealment of income' in section 271(1)(c) should be dealt with separately, because of the supposed requirement of mens rea in such cases, needs further consideration. It is submitted that there appears to be no justification for differential treatment of such penalties, particularly as the Legislature has progressively extended the principle of strict liability to cases of concealment of income or furnishing inaccurate particulars of such income[17].

Burden of Proof.

Burden of proof means the obligation to prove the truth or falsehood of a fact[18] or proposition, Proof however, does not mean proof in the rigid, mathematical sense, because that is not possible[19]. In a criminal case it means such

---

16. (1968), Government of India, pp.73,74. Mr. Bhoothalingham says: "... A s far as possible penalties except for deliberate concealments, should be dealt with along with the assessments. If this is done numerous unnecessary delays leading to the same evidence being repeatedly gone into by different authorities can be avoided."
17. See Chapter 6 pp. 301-17 for discussion on the point.
18. Bhoormal Premchand v. Collector of Customs, Madras, A.I.R. 1967 Mad. 39 at p.43.
19. 'The Law of Evidence', Ratanlal Ranchhoddas and Dhirajlal Keshavlal, (8th ed., 1939), p.8.

evidence as would induce a reasonable man[20], in the particular circumstances of the case in which the claim arises, to act upon the supposition that it exists[21]. Generally the burden of proof rests upon the person who substantially asserts the affirmative and not upon the person who denies it[22]. The rule has its origin in the Roman maxim: Ei qui affirmat non ei qui negat incumbit probatio[23]. The maxim is based upon two considerations, viz., he who seeks the aid of the court should be the first to prove that he has a case and that in the nature of things it is more difficult to prove a negative than the affirmative. The burden of proof may, however, be shifted by action of the parties and by statutory enactments[24]. The standard or the degree of proof also varies according to the nature of the proceedings[25]. For instance, in case of civil proceedings a mere preponderance of probability is sufficient, whereas in criminal proceedings proof beyond reasonable doubt[26]

---

20. See Chapter 7 pp.391/2 for 'a reasonable man' test.
21. The Indian Evidence Act (1 of 1872), section 103; 'Fraud in Federal Income Tax', Myron L. Gorden, (1948), 32 Marquette L. Rev. 120, at p. 127.
22. 'Phipson an Evidence', (11th ed. 1970), b 90.
23. Ibid. Digest on the Law of Evidence, Stephen, Article 104; Law of Evidence, S.C. Sarkar, 9th ed. (1953), p.764.
24. Ibid.
25. 'Evidence', Rupert Cross, (3rd ed. 1967), p.87).
26. Ibid., at p.88. See for meaning of 'proof beyond reasonable doubt' Miller v. Minister of Pensions (1947) 2 All. E.R. 372, at pp. 373,374, per Lord Denning; R v. Kritz (1950) 1 K.B. 82,90 and R. v. Summers (1952) 1 All E.R. 1059 per Lord Goddard, C.J.; See Standards of 'Proof in the Divorce Court', Prof. Coutts (1951), 14, Mod. L.R. 411.

is required for conviction. In brief, the rules of burden of proof may be summarized in the words of Stephen as follows:

> "the burden of proof as to any particular fact lies on that person who wises the court to believe in its existence, unless it is provided by any law that the burden of proving the fact shall lie on any particular person; but the burden may in the course of a case be shifted from one side to the other, and in considering the amount of evidence necessary to shift the burden of proof the court has regard to the opportunities of knowledge with respect to the fact to be proved which may be possessed by the parties respectively."[27]

The burden of proof is used in two distinct senses, viz., the burden of establishing a case and the duty to adduce evidence[28]. The burden of proof in the former sense is fixed by law and always rests upon the person, whether plaintiff or defendant, who substantially asserts the affirmative of the case[29]. On the other hand, the burden of proof in the latter sense is unstable and may shift from one side to the other during the course of the trial. The burden of proof in this sense lies on the person, who would fail if no evidence were given on either side. As stated by their Lordships in Abranath v. N.E. Railway;

---

27. A Digest of the Law of Evidence, Stephen 12th ed. (1836), Art. 104. The word 'Evidence' is derived from Latin term 'evidens evidera' - which means to show clearly, to make clear to the sight.
28. Supra note 22, p. 91; Halsbury's Laws of England (3rd ed.), Vol. 13, para 605.
29. 'Law of Evidence', S.C. Sarkar, (9th ed. 1953), p.767; Thayer has used 'burden of proof' in three ways, viz., "(i) to indicate the duty of bringing forward argument or evidence in support of a proposition at the begiining of the proceedings or later; (11)to establish a proposition against all counter-argument or evidence; (iii) an indiscriminate use in which it may mean either or both of the others. The Indian Evidence Act (1 of 1872). Sections 101 to 114 lay down the rules of 'burden of proof'. Section 101 prescribes the basic rule of 'burden of Proof'.

"The burden of proof rests, before evidence is given, upon the party asserting the affirmative of the issue; and it rests, after evidence is gone into, upon the party against whom the tribunal, at the time the question arises, would give judgement, if no further evidence were adduced."[30]

The provisions relating to burden of proof in income tax proceedings may be discussed in relation to assessment proceedings, best judgement assessment proceedings, additional assessment proceedings, penalty proceedings and prosecutions.

The Income Tax Act, 1961, like the Act of 1922 imposes a general liability to tax on all income[31]. There is a legal obligation on the part of every person, whose total income in a particular year exceeds the maximum amount exempted from taxation, to pay tax. The Act, however, does not provide that whatever is received by a person must be regarded as income liable to tax. Only that income which comes within the taxing provisions is subject to tax. The primary onus probandi, as in other statutes, rests on the Income Tax authorities to show that income which they seek to tax is income liable to be taxed by the statute[32]. However, the burden of proof in such cases is not as heavy as in criminal proceedings. The burden is even less than in ordinary civil proceedings and is discharged by merely

---

30. (1885) 11 Q.B. 440, at p. 456.
31. Income Tax Act, 1961, sections 4 and 5; Paramisetti Seetharanamma v. C.I.T., Hyderabad A.I.R. 1965 S.C. 1905, at p. 1907.
32. Ibid., Devadattam v. Union of India A.I.R. 1964 S.C. 880, 885. Supra note 11, at p.11, Khizar Mohamad v. C.I.T. A.I.R. 1968 J. & K 53,55.

showing that the assessee is in receipt of income[33]. The assessment carries with it a presumption of validity and legality and there is no burden on the Income Tax authorities to show by positive evidence that the accounts are unreliable or that the figure at which they assess it is correct. As stated by the Lahore High Court in Messrs Ganga Ram-Balmokand v. C.I.T.:

> "It cannot be denied that there must be some material before the Income Tax Officer on which to base his estimate, but no hard and fast rule can be laid down by any Court to define what sort of material is required on which his estimate can be founded. The law nowhere contemplates that the Income Tax Officer is a party to the case in the sense in which an ordinary party to civil litigation is, and he cannot be expected to be in possession of such evidence as would be required from an ordinary litigant to refute the case of his adversary."[34]

The Income Tax Officer's finding cannot be discharged, unless of course it is altogether capricious and injudicial[35]. If an assessee receives a certain sum of money in the relevant accounting year or certain cash is found credited in his account, it is for him to explain from where he got the money. The burden lies on the assessee to explain to the Income Tax authorities the true nature and source of these receipts. The rationale for the rule that the burden of

---

33. C.I.T., Bihar and Orissa v. Visheswar Singh A.I.R. 1935 Pat.342 p.343; C.I.T. and E.D.T., Madras v. South Indian Pictures Ltd., A.I.R. 1952 Mad. 231; see 'The Burden of Proof in Tax Disputes', Horst g. Wolf (1970) 18 Can. Tax Journal, p. 1. C.I.T. W.B. v. Messrs. Ukhara Estate A.I.R. 1971 Cal. 125.
34. A.I.R. 1937 Lah. 721 (Quoted from head note).
35. Lalchand Bhagat Amblica Ram v. C.I.T., Bihar and Orissa, 1959 S.C. 1295.

proof should be on the assessee is that the taxpayer, alone, is the person best able to reveal the facts of his financial circumstances. And the taxpayer knows better than anyone else the amount of his taxable income.

The taxing authorities could not be expected to render evidence about the facts, which are within the special knowledge of the taxpayer[36]. If the assessee fails to give a satisfactory account of the source and nature of such receipt, the Income Tax Officer is entitled to draw the inference that the receipts are of an assessable nature[37] and can lawfully make an assessment accordingly.

The Courts appear to be unanimous in this regard. For instance, Allahabad[38], Patna[39], Calcutta[40], Lahore[41],

---

36. The Indian Evidence Act (1 of 1872), section 106 states that: "When any fact is specially within the knowledge of any person, the burden of proving that fact is upon him." See Messrs. Ganga Ram-Balmokund v. C.I.T. A.I.R. 1937 Lah. 721; Lal Mohan Krishna Lal Paul v. C.I.T., Bengal, A.I.R. 1945 Cal. 62; Harprasad Shiva Dutt Rai v. C.I.T., U.P., A.I.R. 1957 All. 746.
37. Govindarajulu Mudaliar v. C.I.T., Hyderabad A.I.R.1959 S.C. 248; Sreelekha Banerjee v. C.I.T., Bihar and Orissa A.I.R. 1964 S.C. 697.
38. Har Prasad Shiva Dutt Rai v. C.I.T., U.P. A.I.R. 1957 All 746; Mithoolal Tek Chand v. C.I.T., U.P. A.I.R. 1953 All 701; Kanhaiyalal Umrao Singh v. C.I.T. (1941) 9 I.T.R. 225 (Oudh); Ganga Prasad v. C.I.T., U.P. (1941) 9 I.T.R. 373 (All).
39. Manindranath Das v. C.I.T., Bihar and Orissa A.I.R. 1954 Pat. 610. S.N. Ganguly v. C.I.T. A.I.R. 1954 Pat. 51.
40. Lal Mohan Krishna Lal Paul v. C.I.T., Bengal A.I.R. 1945 Cal. 62, J.A. Shellim v. C.I.T., Bengal A.I.R. 1947 Cal 338.
41. Ganga Ram Balmokand v. C.I.T. A.I.R. 1937 Lah. 721.

(now in Pakistan) Rangoon[42], (now in Burma) Madras[43], Bombay[44], Punjab[45], Nagpur[46], the Privy Council[47] and the Supreme Court of India have said with one voice that the burden of proof in such cases was upon the assessee[48]. Hidayatullah, J., in a fairly recent case in the Supreme Court Sreelekha Banerjee v. C.I.T., Bihar, briefly summarized the law on the point in the following words:

> "...[I]f there is an entry in the account books of the assessee, which shows the receipt of a sum or conversion of high denomination notes tendered for conversion by the assessee himself, it is necessary for the assessee to establish, if asked, what the source of that money is and to prove that it does not bear the nature of income. The Department is not... required to prove anything... I f,... the explanation is unconvincing and one which deserves to be rejected, the Department can reject it and draw the inference that the amount represents income, either from the sources already disclosed by the assessee or from some undisclosed source. The Department does not then proceed on no evidence, because the fact that there was receipt of money, is itself evident against the assessee.... The very words 'an undisclosed source' show that the disclosure must come from the assessee and not from the Department."[49]

---

42. C.I.T., Burma v. Dey Brothers A.I.R. 1936 Ran. 219.
43. G.M. Madoppo v. C.I.T. Madras A.I.R. 1949 Mad. 246.
44. Norayandas Kedarnath Ram v. C.I.T.Bombay A.I.R. 1952, Bom.459.
45. Raghunath Singh v. C.I.T., Simla, A.I.R. 1965 Pun. 436.
46. Naidu Cinema Exhibitor v. C.I.T., Nagpur, A.I.R. 1956. Nap. 157.
47. C.I.T., Bihar and Orissa v. Maharajadhiraja of Barbhanga, 1933 1, I.T.R. 94, 106, (P.C.)
48. Govindraorajulu Mudaliar v. C.I.T., Hyderabad, A.I.R. 1959 S.C. 248; Sreelekha Banerjee v. C.I.T., Bihar, A.I.R. 1964 S.C. 697; Messrs. Mehta Pariah and Co. v. C.I.T., Bombay, A.I.R. 1956, S.C. 554.
49. A.I.R. 1964 S.C. 697, pp.701,702. Messrs. Lalchand Bhagat Ambika Ram v. C.I.T. B. & O. A.I.R. 1959 S.C. 1295.

It may not be out of place to pinpoint an anomaly in the Supreme Court's view in this connection. Whereas, the Supreme Court in the above-mentioned cases of Govindrajulu Mudaliar[50] and Sreelekha Banerjee[51] have held that the burden of proof lies on the assessee to show that the income does not bear the character of income, it said in Parimisetti Seetharanamma v. C.I.T., Hyderabad[52], that it is for the Department to establish that receipts are chargeable to tax.

The material facts of Parimisetti's case lie within a narrow compass. The Income Tax Officer found a certain sum of money, approximately Rs.5,20,000 notes in the appellant's account for the years 1946-47, 1947-48, 1950-51 and 1951-52, which was not brought to taxation. The appellant's contention that the sums were given to her out of love and affection by the Maharani Sita Devi Gaekwad of Baroda and so exempted from taxation under section 4(3)(vii) of the Act of 1922[53], was rejected by the Income Tax Officer because she failed to give satisfactory evidence about the gift. The Income Tax Officer held that the sum was

---

50. A.I.R. 1959 S.C. 248.
51. A.I.R. 1964 S.C. 697.
52. A.I.R. 1965 S.C. 1905.
53. Income Tax Act, 1922, section 4(3)(vii) provided that: "Any income, profits or gains falling within the following classes shall not be included in the total income of the person receiving them:

 ...

 (vii) Any receipts ..., which are of a casual and non-recurring nature or are not by way of addition to the remuneration of an employee.".

remuneration for services rendered by the assessee as a maid-servant or secretary to the Princess and accordingly taxable. The amount was held to be income of the assessee liable to be taxed under section 34 of the Act of 1922.

The Tribunal and the High Court concurred with the Income Tax Officer but the Supreme Court held that the income would not be liable to tax by reason of the assessee's failure to prove that the income was a gift by way of natural love and affection. Their Lordships held that the taxpayer was not liable to prove her case, accepted her statement that the money was a gift and held the Department responsible to establish that such income was taxable. The Court said:

> "...In all cases in which a receipt is sought to be taxed as income, the burden lies upon the Department to prove that it is within the taxable provision." [54]

The statement is in apparent conflict with that made by the Supreme Court in <u>Sreelekha Banerjee's</u> case, wherein their Lordships have stated that:

> "...[I]t is plain that if there is a receipt of an amount in the accounting year, it is incumbent in the first instance upon the assessee to show that it does not bear the character of income. If he fails to do this the Income Tax Officer may hold that it represents income of the assessee either from the source he has disclosed or from some undisclosed source."[55]

It is submitted with respect that the Supreme Court unduly stretched the provisions in favour of the taxpayer. Could it be imagined, by any stretch of imagination, that anyone would give such a huge sum out of natural love and

---

54. A.I.R. 1965 S.C. 1905, at 1907 (para 6).
55. A.I.R. 1964 S.C. 697 at p. 700 (para 8).

affection, unless the donor and donee were intimately related in some way or other. In fact, the assessee was not related to Sita Devi and did not belong to the Royal family; she belonged to a family of Dasis (maid servants). Under the circumstances, as noted by the High Court below:

> "...[W]here admittedly the assessee was in receipt of large sums of money as shown in the accounts submitted by her, that they were outside the rule of a taxable income was a matter which had to be stablished by the assessee herself... The bare allegation, unsupported by any evidence, in our opinion was not sufficient to discharge the burden which lay upon the assessee... the burden lay upon the assessee in this case to establish that the amounts received were voluntary payments made by the Princess out of love and affection."[56]

In regard to the claim for exemption from taxation there appears to be no controversy. The burden of proving that income received is exempt from taxation[57], or that a

---

56. Parimisetti Seetharanamma v. C.I.T., Hyderabad, A.I.R. 1965 S.C. 1905 at p. 1907 (para 6).
57. C.I.T., Bihar and Orissa v. Ramarishna Deo (1959) 35, I.T.R., 312,316-7 (S.C.); Keren Kayemethe le Jisroel Ltd. v. I.R. (1932) 17 T.C. 27,58(H.L.); Udhavdas Kewalram v. C.I.T., Bombay City (1967) 66 I.T.R. 462 (S.C.); Madras Provincial Corporation Bank Ltd. v. C.I.T. Madras A.I.R. 1933 Mad. 489; Beohar Singh Raghubir Singh, v. C.I.T., Nagpur, I.L.R. 1947 Nag. 425,445; C.I.T., Madras v. Maddi Venkatasubbayya, A.I.R. 1951, Mad. 1007; C.I.T. v Venkataswami Naidu, A.I.R. 1956 S.C. 522. Smt Charusila Dassi, in re, A.I.R. 1947 Cal. 148,151; Rani Amrit Kunwar v. C.I.T., Punjab, 1946 I.T.R. 561,575; In the United States in a suit by a taxpayer against the Government for recovery of income taxes and penalties alleged to have been illegally and erroneously assessed and collected, it was held that the burden lay upon the assessee. Wesley O. Paddock v. U.S. (1960) (U.S.C.A.) 280F (2d) 563.

claim to any allowance or deduction should be allowed[58], or that losses in business should be set-off[59], lie on the taxpayer who wants to take advantage of the relevant statutory provisions.

This becomes evident from two cases of Supreme Court, viz., C.I.T., Bihar and Orissa v. Ramkrishna Deo[60] and C.I.T., Madras v. Venkataswamy Naidu[61]. In these cases the taxpayers claimed exemption from taxation under section 4(3)(viii) of the Act of 1922, on the ground that the income earned was agricultural income, exempt from taxes.

In Ramkrishna Deo's[62] case, the point for decision was whether income received by the respondent by the sale of trees growing in his forest was agricultural income, as

58. Gopi Nath Vir Bhan v. C.I.T., Punjab, A.I.R., 1938, Lah 530; C.I.T. , West Bengal v. Calcutta Agency Ltd. (1951) 19 I.T.R., 191, 196 (S.C.) A.I.R. 1951 S.C. 108; United Steel Co. Ltd. v. Cullington (Inspector of Taxes) (1941) 9 I.T.R. Suppl. 20,35 (H.L.); Hotz Simla Trust v. C.I.T.,E.P.(1952), 21 I.T.R. 149, Lakshmiratan Cotton Mills Co. Ltd. v. C.I.T.,U.P. A.I.R. 1969 S.C. 917. Amar Nath v. Hukam Chand-Nath Mal A.I.R. 1921 P.C. 35.
59. Radhakrishan Ramnarain v. C.I.T. 3 I.T.C. 366; Jamna Das Rameshwar Das v. C.I.T., Delhi (1952) 21 I.T.R. 109.
60. A.I.R. 1959 S.C. 239.
61. A.I.R. 1956 S.C. 522.
62. A.I.R. 1959 S.C. 239.

defined in section 2(1) of the Act of 1922[63], and so exempt from taxation under section 4(3)(viii) of the Act. The Income Tax Officer, on respondent's failure to prove that there was a plantation of trees, held that the forest in question had not been proved to have been planted by the respondent, that the trees were of spontaneous growth, and that the income therefrom was not within the exemption under section 4(3)(viii) of the Act.

The Orissa High Court, allowing the respondent's appeal from the Tribunal, held that the burden of proof lay upon the Income Tax Department to show that the income earned from the forest was chargeable to tax and fell outside the scope of the exemption in section 4(3)(viii) of the Act; it did not rely on the assessee to prove that the income was exempt from taxation. Their Lordships of the Supreme Court

---

63. Income Tax Act, 1922, in section 2(1) has defined "agricultural income". The present Income Tax Act, 1961, has incorporated the same definition in section 2(1). In Beohar Singh Raghubir v. C.I.T.,U.P. & C.P. I.L.R. 1947 Nag. 425. The Court has very nicely defined the term "agriculture" in the following words at p. 425: "Agriculture is the art or science of cultivating the ground and requires the human skill and labour. Forests of spontaneous growth which have come into being without the use of such skill do not fall within this definition." In this case the Court rejected the assessee's claim that income earned by the sale of forest produce was exempt from taxation under section 4(3)(viii) of the Act of 1922, because the assessee failed to prove that the forest was 'cultivated' in the sense that its produce was due to the skill and labour which he had expended on it, as opposed to produce which would come naturally despite inaction on his part.

rightly dissented from the High Court's proposition and held that the income was liable to taxation, as the assessee failed to prove that the income was exempt from taxation. Venkatarama Aiyar, J., speaking for the Court, said:

> "... The law is well settled that it is for a person who claims exemption to establish it, and there is no reason why it should be otherwise, when the exemption claimed is under the Income Tax Act... There is ample authority for the view that the principle that a person who claims the benefit of an exemption has to establish it, applies when the exemption claimed is under the provisions of the Income Tax Act." [64]

Similarly, Bhagwati, J., while delivering the judgement of the Court in Venkataswamy Naidu's case said:

> "In order to claim an exemption from payment of income tax in respect of what the assessee considered agricultural income, the assessee had to put before the Income Tax authorities proper materials which would enable them to come to a conclusion that the income which was sought to be assessed was agricultural income. It was not for the Income Tax authorities to prove that it was not agricultural income."[65]

In brief, the facts were that the assessee, a Hindu undivided family, owned 70 acres of agricultural land. It also maintained on the estate 65 cows and 10 pairs of bulls. The assessee sold milk for Rs.28,000 to the Co-operative Milk Supply Union during the financial year 1946-47. The assessee claimed that the profits from the sale of milk constituted agricultural income and, as such, were exempt from income tax. The Income Tax Officer rejected the respondent's claim as,

---

64. A.I.R. 1959 S.C. 239 at p. 241 (para 5).
65. A.I.R. 1956 S.C. 522, at p. 525 (para 8); A similar question was raised before the Nagpur High Court in Beohar Raghubir Singh v. C.I.T., U.P. & C.P., I.L.R.1947, Nag. 425. It was held that the burden lay upon the assessee who wanted to claim the benefit of the exemption.

he failed to produce any material to show that the income received by him from the sale of milk was agricultural income. He accordingly assessed the income to tax.

It was held that the Income Tax Officer was justified under the circumstances to treat the income as liable to tax, because the assessee failed to produce before the Income Tax Officer the materials to enable him to decide whether the income from the sale of the milk was agricultural income, as claimed by the respondent.

Assessment Proceedings

As has been noted earlier the Income Tax Officer can make a best judgement assessment[66] in certain cases, if the assessee fails to comply with the requirements of the Act. Such assessments will be deemed valid in law for all purposes. If the assessee wants to get the assessment cancelled, it is for him to show that he was prevented by 'sufficient and reasonable cause' from complying with the terms of the notice issued by the Income Tax Officer.[67] Similarly, the onus is on the taxpayer to show that the assessment made by the Income Tax Officer is incorrect.[68]

---

66. See Chapter 2, pp.51-54 for 'best judgement assessment'.
67. C.I.T., Bombay City v. Dhanmal Chellaram (1948) 16 I.T. R. 319,322; Abdul Baree Choudhary v. C.I.T., 5 I.T.C.,352, 358,359.
68. Commercial Hotel Ltd. v. M.N.R., (1948) Ex. C.R. 108; 3 D.T.C, 1119; Dezura v. M.N.R., (1948) 3 D.T.C. 1101; Jasperson v. M.N.R. (1954) Ex.C.R. 29, see 'Introduction to Income Tax Law: Canada, Francis Eugena La Brie, 1955, p.345. In U.S. also the burden lies on the taxpayer, Cefalu v. C.I.R. (1960) C.A.5. 276 F 2d p. 122.

There appears to be conflict among the High Courts in regard to the burden of proof in reassessment proceedings[69] under section 147 of the Act of 1961 (corresponding to section 34 of the Act of 1922). For instance, the Bombay[70], Calcutta[71], and Allahabad[72] High Courts have held that the burden of proving that the income escaping assessment was taxable income of the assessee in the relevant year was on the Income Tax authorities. For instance, Beaumont C.J., in C.I.T., Bombay v. Gopal Vaijinath, said:

> "...[T]he burden of showing that income has escaped assessment or that it has been assessed at too low a rate, lies on the Commissioner."[73]

On the other hand, a special bench of the Rangoon High Court in C.I.T.,Burma v. Dey Brothers[74] dissented from the Bombay High Court's view. Page,C.J., who delivered the judgement for the Court, observed that the question 'whether the income has escaped or not' was a question of fact to be decided by the Income Tax authorities and the Courts should not interfere with their findings. A somewhat similar

---

69. See Chapter II,pp.64, 67for'Assessment of escaped income'
70. C.I.T., Bombay v. Gopal Vaijnath, I.L.R. (1935) 59. Bom. 626; C.I.T., Bombay v. C.V. Manohar (1935) 3 I.T.R. 372;
71. Lal Mohan Krishna Lal v. C.I.T., Bengal, A.I.R. 1945 Cal. 62.
72. Laljimal Girdhar Das v. C.I.T., U.P. (1951) 19 I.T.R. 418 (All); Radhey Lal Jawahar Lal v. C.I.T., U.P., Misc. Case no.3 of 1949, D/ 16.1.1952 (unreported) quoted from Mithoo Lal v. C.I.T., U.P., A.I.R. 1953 All 701; In re Ram Datta Sita Ram of Basti (1947) 15 I.T.R. (All) (F.B).
73. I.L.R. (1935) 59 Bom. 626 at p. 631. A similar statement was made by Rangnekar, J., while delivering a judgement for himself at p.632.
74. A.I.R. 1936 Rang. 219.

view was taken by the Allahabad High Court in Mahabir Prasad Munna Lal v. C.I.T., Cawnpore[75], the Patna High Court in Manindranath Dash v. C.I.T., Bihar and Orissa[76] dealing with a proceeding under section 34 of the Act of 1922 in which tax had been assessed on money received by cashing certain high denomination notes during the assessment year 1946-47 as secret profit, held:

> "... [I]f the assessee receives a certain amount in the course of the accounting year, the burden of proof is upon the assessee to show that the item of receipt is not of an income nature; and if the assessee fails to prove positively the source and nature of the amount of the receipt, the revenue authorities are entitled to draw an inference that the receipt is of an income nature. The burden of proof in such a case is not upon the department but the burden of proof is upon the assessee to show by sufficient material that the item of receipt was not of an income character."[77]

The Punjab High Court in Raghunath Singh v. C.I.T., Simla[78] has expressed similar views in this regard.

The Supreme Court seems to have settled the controversy on the point in favour of the latter view. In Sreelekha Banerjee v. C.I.T.,Bihar and Orissa[79],the Court was directly confronted with the question. Their Lordships rejected the appellant's contention that the case, being one under section 34 of the Act, a special burden was cast on the

---

75. A.I.R. 1947, All 414.
76. A.I.R. 1954 Pat. 610.
77. A.I.R. Pat. 610 at p. 611 (para 3).
78. A.I.R. 1965 Punjab 436.
79. A.I.R. 1964 S.C. 697. See Govindarajulu Mudaliar v. C.I.T., Hyderabad A.I.R. 1964 S.C. 697 1959 S.C. 248; Mehta Parikh and Co. v. C.I.T., Bombay, A.I.R. 1956 S.C. 554; Sovachand Baid v. C.I.T., 1959 S.C. 59; Lalchand Bhagat v. C.I.T. A.I.R. 1959 S.C. 1295.

Income Tax Department to show that the income had escaped assessment earlier, and observed that:

> "...[T]here is no difference between an ordinary assessment and an additional assessment under S.34, and the same rule as to burden of proof governs the additional assessment."[80]

Penalty Proceedings and Prosecutions.

As discussed earlier[81] the burden of proof in penalty proceedings depends on whether such proceedings are civil or criminal in nature. The Courts are divided on the issue. If the proceedings are accepted as civil in nature, the ordinary procedure applicable in case of assessment proceedings will apply. On the other hand, if such proceedings are to be treated as criminal in nature, the burden of proof will, obviously fall on the Income Tax authorities, particularly in cases where the penalty is levied under section 271(1)(c) of the Act[82], on account of the assessee's fraudulent conduct. In other cases, where the penalty is levied because of the assessee's failure to comply with the statutory requirements under the Act without any reasonable cause[83], it appears that the burden will lie on taxpayers to show, that there was sufficient justification for its non-fulfilment. In the absence of any case on the point, nothing can be said definitely as to how the courts

---

80. Ibid. p. 792 (para) 16); Baladin Ram v. C.I.T., U.P. A.I.R. 1969 S.C. 351.
81. See Chapter 6, pp.300-17 and Chapter 7, pp. 1-19.
82. See Chapter 6, pp.286-7
83. See Chapter 6, pp.317-39 for cases.

will interpret such cases[84].

There is no scope for controversy in such proceedings. The well accepted principle of criminal law that burden of proof lies on the prosecution will apply. The Income Tax authorities are to prove their case beyond reasonable doubt before any conviction can be declared.[85] A taxpayer can take the plea of defences available to an accused in criminal cases[86].

Constitutionality of Income Tax Legislation

Perhaps, the first case in which the constitutionality of an anti-avoidance measure was challenged in the Federal

---

84. There are two cases stating that if an assessee wants to get a best-judgement assessment order cancelled, he must show that the failure to comply with the statutory requirements, which led the Income Tax Officer to make an ex-parte judgement, was due to 'reasonable cause'. The cases are: C.I.T. v. Bhanmal Chellaram, (1948) I.T.R. 319 Abdul Baree Choudhary v. C.I.T., 5 I.T.C. 352,358,359; In the United States under similar situations the burden of proof has been placed on the taxpayer. Breland V. U.S. 1964 (C.A.5.) 323F (2d) 492, 497; William Estate of T. Mayer v. C.I.R. (1965) 351 F (2d) 617; see Joseph A. Cirilla and Mertha R. Cirilla v. C.I.R. (1963) (U.S.C.A.3) 314 F 2d 478
85. The law is similar in other countries. See Acme Slide Fastener Co. Ltd. v. The Queen (1962) 62 D.T.C (26) (Canada) Cliford v. I.R.C. (N.Z.) (1966) 9 A.I.T.R. 35; U.S. v. Mardock 290 U.S. 389.
86. In U.S. v. Sheller (1966) (C.A.2) 369, F 2d 293. The plea of insanity was raised in connection with tax evasion crimes and upheld by the Appellate Court.

Court of India is A.H. Wadia v. C.I.T., Bombay[87]. This was an appeal on a certificate granted by the High Court of Bombay against a decision in favour of the respondent.

The appellant was the agent of Gwaliar State, outside British India. The State advanced a loan of Rs.50 lakhs to a company, a Provident Investment Co. Ltd. incorporated in British India. The money was paid in Gwalior and the interest was payable there. The money was brought into British India and utilized in the Corporation's business. The Income Tax Officer treated the transaction of lending this money outside India and bringing it into India as integral parts of one composite transaction as contemplated by section 42(1) of the Act of 1922. He accordingly, levied tax on the interest earned. The relevant portion of section 42(1) provided that:

> "All income, profits or gains accruing or raising, whether directly or indirectly,... through or from any money lent at interest and brought into the taxable territories in cash or in kind... shall be deemed to be income accruing or arising within the taxable territories ... ".

It was contended by the appellant that the impugned section was ultra vires inasmuch as it was extra-territorial in operation. It was also contended that the provision was ultra vires the power of the Central legislature granted by

---

87. A.I.R. 1949 F.C. 19; in Messrs. Anwar Khan Mehboob v. Commissioner of Sales Tax, M.P., (1970) 2 S.C.W.R., 770 the Supreme Court held that the legislature was competent to enact laws on the principle of territorial nexus.

item 54 in the Federal list of the 7th Schedule to the Government of India Act, 1935, "taxes on income other than agricultural income".

The Court rejected the appellant's contention and held that the Indian legislature was competent to enact laws in such a way that its revenue laws were not defeated by a subterfuge. Section 99 of the Act empowered the Central legislature to legislate for British India and without prejudice to the generality of that provision, to make laws with extra-territorial operation in certain cases not relevant here. The Court applied the doctrine of territorial nexus and held that there was sufficient connection between British India and the interest payable to a foreigner outside British India to bring the impugned provisions within the legislative power. Mahajan J. rightly said:

> "... A foreigner cannot escape liability to tax by resorting to a device or subterfuge, when, in effect, he is deriving income from a field of activity that is in India, or where a contract of loan, ostensibly made outside, is, in effect made in India. By changing the venue of the contracted loan, the jurisdiction of the legislature cannot be avoided, when the real purpose is to lend money in India."[88]

After the Constitution of India came into force, the Supreme Court was faced with the question of the legality of certain important and crucial provisions enacted to combat tax evasion prevalent in the country during 1940-50. It

---

88. Ibid. at p.38 (para 59). Patanjali Sastri J., gave a dissenting judgement and held that the provision was *ultra vires* because there was no sufficient territorial connection between the borrower and the bringing of money into India.

was found that, during the last World War, large fortunes had been made by businessmen, while wartime controls were in force, by black marketering and hoarding essential goods. The secret profits thus made were not brought to assessment and were not deposited in banks; they were used to purchase shares or real property, in the name of benamidars, (ostensible owners), to the purchase of gold, silver and jewellery. The machinery available to the Income Tax authorities for assessment of income escaping assessment under section 34 of the Income Tax Act, 1922[89], was considered inadequate to cope with the large number of complex cases of war profiteering. As a result in 1947, the Taxation on Income (Investigation Commission) Act (30 of 1947), was passed by the Central legislature to deal with the cases of tax evasion arising out of profiteering from the beginning of the War on 1st June, 1939 to the 1st September, 1947. A Commission known as the Income Tax Investigation Commission was constituted under section 3 of the Act to investigate and report to the Government any case or matter referred to it by the Government under section 5 of the Act.

Sub-sections (4) and (1) of section 5 of the Act were challenged in the Court for violation of the right to equality before the law, guaranteed by Article 14 of the Constitution, on the ground that the procedure applicable

---

89. See infra footnotes 93,96 for section 34 of the Act of 1922, at pp. 493,499 respectively.

in the cases of war-profiteers was less favourable to the assessees than that applicable in other cases under section 34 of the Act of 1922. Three cases dealing with the point ultimately resulted in the winding up of the Investigation Commission. They are Suraj Mall Mohta and Co. v. A.V. Visvanatha Sastri[90], Shree Meenakshi Mills v. Visvanatha Sastri[91] and M.Ct Muthiah v. C.I.T., Madras[92].

In the first case, Suraj Mall Mohta, the Court held that sub-section (4) of section 5 of the Act (30 of 1947) was repugnant to the equality clause in the Constitution.

The Central Government referred to the Income Tax (Investigation Commission) the investigation of secret profits made by the petitioner during the war period which had not been disclosed and which had evaded payment of taxes. The reference was made to the Commission in pursuance of its request to the Government under sub-section (4) of S.5 of the Taxation of Income (Investigation Commission) Act 30 of 1947, which provided that:

> "If in the course of investigation into any case or points in a case referred to it under sub-section (1), the Commission has reason to believe-
>
> (a) that some person other than the person whose case is being investigated has evaded payment of taxation on income, or
>
> (b) that some points other than those referred to it by the Central Government in respect of any case also require investigation, it may make a report to the

---

90. A.I.R. 1954 S.C. 545.
91. A.I.R. 1955 S.C. 13. Infra f.n. 93,96 for s. 34 of the Act of 1922 at pp. 593,499 respectively.

> Central Government, stating its reason for such belief, and on receipt of such report, the Central Government shall, ... refer to the Commission for investigation of the case of such other person or such additional points as may be indicated in that report."

Act 30 of 1947 provided a special procedure to be followed in such cases under sections 6, 7 and 8,which was more comprehensive and drastic in nature than that contained in the Indian Income Tax Act, 1922, inasmuch as the procedure prescribed by the Act for investigation under its provisions was of a summary nature. It constituted a departure from the ordinary law of procedure contained in the Income Tax Act.

The petitioner moved the Supreme Court under article 32 of the Constitution for the issue of appropriate writs restraining the Commission from taking any action under the provisions of Act 30 of 1947 on the ground that sections 5(4), 5(1), 6, 7 and 8 of the Act were discriminatory in character and offended against Article 14 of the Constitution.

Their Lordships upheld the petitioner's contention and said that sub-section (4) of section 5 of the Act 30 of 1947 gave arbitrary power to the Commission to pick and choose what matters it would enquire into, and was highly discriminatory in character in that an evasion, whether substantial or not, came within its ambit, as well as within the ambit of section 34[93] of the Income Tax Act, 1922.

---

93. Income Tax Act, 1922, section 34 had provided provision for assessment of escaped income. The corresponding provisions are contained in S. 147 of Income Tax Act, 1961. See Chapter 2, p.65. See <u>infra</u> note 96.

The Court held that the impugned sub-section was not limited in its application to those persons who made extraordinary profits and to a substantial extent evaded payment of taxation on income but applied to all persons who might have evaded payment of taxation on income and whose cases fell within section 34 of the Act of 1922. There was no justification for discriminating against them by applying to them a procedure different from that provided by the Income Tax Act. The procedure prescribed under the impugned provisions of Act 30 of 1947 were obviously more prejudicial to the assessee than the procedure prescribed under the Income Tax Act, inasmuch as the former deprived the assessee of the rights of appeal, second appeal and revision and that investigation into concealed income was not limited to the period of eight years, laid down in the Income Tax Act. The Court accordingly, held sub-section (4) of section 5 of the Act 30 of 1947 void for repugnancy to Article 14, as a discriminatory piece of legislation.

In the second case, Shree Meenakshi Mills Ltd. v. A.V. Vishvanatha Sastri[94], the Supreme Court declared sub-section (1) of section 5 of Act 30 of 1947 unconstitutional with effect from July, 17, 1954, after the introduction of sub-section (1-A) to (1-D) in section 34 of the Income Tax Act, 1922.

---

94. A.I.R. 1955 S.C. 13.

This was a petition under Article 32 of the Constitution, challenging the validity of sub-section (1) of Section 5 of Act 30 of 1947, under which the petitioners cases were referred by the Government to the Income Tax Investigation Commission for investigation of alleged evasion of taxes. The impugned sub-section (1) provided that:

> "The Central Government may at any time before the first day of September 1948 refer to the Commission for investigation and report any case or points in a case in which the Central Government has 'prima facie' reasons for believing that a person has to a substantial extent evaded payment of taxation on income..."

It was urged on behalf of the petitioner that sub-section (1) of section 5 of the Act was repugnant to Article 14 of the Constitution. Though a valid law must not discriminate between persons or things similarly situated, it is permissible to classify persons or things and treat them differently, provided there is a reasonable basis for the classification.

The Court held that the classification of cases to which Act 30 of 1947 applied was not valid. The word 'substantial' used in the section was vague and uncertain, having no fixed meaning; it could furnish no basis for any classification at all. It was further pointed out that Government was empowered by the clause to discriminate between persons in the same category, inasmuch as it could pick and choose the cases sent to the Commission for investigation and show favouritism to others by leaving them to be dealt with under the Income Tax Act, though all might belong to the same class of persons, who had evaded payment of tax to a substantial extent.

By the time the petition came before the Court for hearing, section 34 of the Income Tax Act, 1922, had been amended by the Income Tax Amendment Act (33 of 1954) and sub-section (1-A) to (1-D) had been added. The relevant portion of sub-section (1-A) provided that:

> "If in the case of an assessee, the Income Tax Officer has reason to believe-
>
> (i) that income, profits or gains chargeable to income tax have escaped assessment for any year... beginning on the 1st day of September, 1939, and ending on the 31st day of March, 1946; and
>
> (ii) that the income, profits or gains which have so escaped assessment ... amount,... to one lakh or rupees or more;
>
> he may,... proceed to assess or reassess the income, profits or gains of the assessee..."

The Cpurt, as in Suraj Mall Mohta's case, did not express an opinion on the validity of S. 5(1) of the impugned Act, as being based on a valid classification and so safe from avoidance for repugnancy to Article 14 of the Constitution. However, on a comparison of the provisions of S. 5(1) of the Act with those of S. 34(1-A) of the Income Tax Act, 1922, their Lordships arrived at the conclusion that the new sub-section inserted in S.34 was intended to deal with the same class of persons as were said to have been classified for special treatment by S.5(1) of the Act 30 of 1947. Of course, section 34(1-A) of the

Income Tax Act, 1922, was an improvement on section 5(1) of the Act 30 of 1947, inasmuch as it did not use the word 'substantial', which had been held to have no fixed meaning and was an unsatisfactory word for designating an ascertainable proportion of a whole, so that it brought about the avoidance of the provision in the Act of 1947. Section 34(1-A) of the Income Tax Act was free from the alledged defect. It was also made clear by the Act that no evasion of less than one lakh was subject to investigation and it was declared that the provisions would not apply to income accruing between 1.9.1939 and 31.3.1946, tax on which had been evaded.

The Court accordingly held that the substantial tax-dodgers or war-profiteers, who were alleged to form a definite class under sub-section (1) of S.5 of Act 30 of 1947 and whose cases needed special treatment at the hands of the Investigation Commission, now, after the insertion of section 34(1-A), fell within the ambit of S.34 of the Income Tax Act. The result was that proceedings could no longer be continued under the provisions of the impugned Act and sub-section (1) of section 5 was struck down as repugnant to the equality clause of the Constitution after section 34(1-A) of the Income Tax Act, 1922, came into force.

In the third case, M.Ct. Muthiah v. C.I.T., Madras,[95] the Supreme Court struck down sub-section (1) of section

95. A.I.R. 1956, S.C. 269.

5 of the Act 30 of 1947, after the coming into force of the Constitution in 1950, with effect from January 26, 1950, as the impugned section was reugnant to Article 14.

The Central Government, in exercise of its power under section 5(1) of Act 30 of 1947 referred the petitioner's case for investigation to the Investigation Commission for alleged evasion of income tax in the years 1940-41, 1941-42 and 1943-44 to 1948-49. The Commission, after holding an inquiry held that the petitioner had received an aggregate sum of Rs. 10,07,322, being undiclosed income for the period under investigation. The Commission gave its report to Government, which started reassessment proceedings. At this stage the petitioners moved the Supreme Court under Article 32 of the Constitution, contending that the provisions of S. 5(1) of the Act 30 of 1947 was unconstitutional.

The grounds alleged were the same as contended in Suraj Mall Mohta and Meenakshi's case, that S.5(1) of Act 30 of 1947 was discriminatory, because it enabled the Central Government to discriminate between one person and another, inasmuch as they were authorized to pick and choose the persons who fell within the group of those who had substantially evaded taxation on income. The act of the Government in referring only some of the evaders to the Commission and leaving others to be dealt with under the Income Tax Act, 1922, was arbitrary and there was nothing to eliminate the possibility of favouritism or discrimination in sending cases to the Commission between persons within the group of those who had evaded the payment of tax to a substantial extent. There was therefore, no justification for enacting a more drastic procedure (i.e., the summary procedure to be adopted in such cases by the Commission) in selected cases than the ordinary procedure prescribed under the Income Tax Act.

The Court while allowing the petition (Jaganadhadas J. contra) held that the impugned section 5(1) was discriminatory and offended against the right to equality before the law provided by Article 14 of the Constitution. It was held that section 34(1)[96], as amended by the

96. Income Tax Act, 1922, section 34 (1) provided that:

"34(1) If-

(a) the Income Tax Officer has reason to believe that by reason of the omission or failure on the part of an assessee to make a return of his income... or to disclose fully and truly all material facts necessary for his assessment for that year, income, profits or gains chargeable to income tax which have escaped assessment for that year or have been underassessed, or assessed at too low a rate, or have been made the subject of excessive relief... or excessive loss or depreciation allowance has been computed, or

(b)... the Income Tax Officer has in consequence of information in his possession reason to believe that income, profits or gains chargeable to income tax have escaped assessment...

He may in cases falling under clause (a) at any time within eight years and in cases falling under clause (b) at any time within four years of the end of that year,.. proceed to assess or re-assess such income, profits or gains...and the provisions of this Act shall,... apply accordingly...".

Act (58 of 1948) with effect from September 8, 1948, was wide enough to cover cases dealt with under section 5(1) of the impugned Act 30 of 1947. Their Lordships repelled the respondent's contention that the substantial tax evaders whose cases were referred by Government to the Commission before 1.9.1948 under section 5(1) of the impugned Act, formed a class by themselves and in leaving others, though belonging to the same class or category of substantial evaders of income tax, to be dealt with by the ordinary procedure prescribed in the Income Tax Act did not infringe the fundamental right guaranteed under Article 14 of the Constitution.

The Court held that the restriction of the operation of the impugned provision to a specified period did not create any special or rational nexus with the necessity for such a drastic procedure. Specifying the period was merely an accident and a measure of administrative convenience; it was not an element in the criteria of the particular class of substantial evaders of income tax.

It is submitted with respect that the majority opinion of the Supreme Court require reconsideration, inasmuch as their Lordships erred in arriving at the conclusion that the impugned section 5(1) of the Act 30 of 1947 became unconstitutional when Constitution came into force.

As stated by Jagannadhadas J., in his dissenting judgement, there was a clear cut distinction between the nature and the scope of section 5(1) of Act 30 of 1947 and section 34(1) of the Income Tax Act, 1922, which justified differential treatment so that the former did not violate Article 14 of the Constitution. The establishment of the Investigation Commission was necessary, because the normal machinery available to the Income Tax Officer under section 34 of the Income Tax Act, 1922 was inadequate for assessment of enormous sums of concealed income arising out of war profiteering. To overcame this lacuna Act 30 of 1947 was passed to enable an investigation of concealed income of war-profiteers to be made by a high-powered commission. Section 5(1) of the impugned Act provided for an investigation of the activities of the anti-social elements in India, who during the war, had made substantial profits, had evaded payment of tax on those profits and whose cases were referred to the Commission before 1.9.1948. This constituted a well-defined class and the classification had a reasonable relation to the object sought to be achieved, viz., the catching up with black marketeers' profits which had escaped assessment. The distinctive features of the impugned section 5(1) and S. 34(1) would be apparent from the following points of difference:-

Section 5(1) was to be invoked only in those cases where the question related to evasion of a 'substantial sum' of money, while section 34(1) was applicable to every case of evasion, however small it might have been.

Section 5(1) required a greater degree of deliberation before setting in motion the machinery for assessment of concealed income, as compared with section 34(1) of the Income Tax Act. For instance, the former provision required a'prima facie' belief on the part of the Government that a person had to a substantial extent evaded payment of taxation on income, whereas section 34(1) required only that the Income Tax Officer had 'reason to believe' before the machinery for re-assessment was set in motion.

A reference could be made by the Government under section 5(1) only during a specified period, i.e., up to 1.9.1948, whereas discovery under section 34(1) any time up to eight years from the conclusion of the assessment year.

In fact, the Supreme Court itself in Suraj Mall Mohta[97] and Shree Meenakshi Mills[98] impliedly upheld the validity of section 5(1) of the Act 30 of 1947 and decided these cases on that assumption.

And the Supreme Court in Thangal Kunju Musaliar v. M. Venkatachalam[99], upheld the constitutional validity of Section 5(1) of the Travancore Taxation on Income

---

97. A.I.R. 1954 S.C. 545.
98. A.I.R. 1955 S.C. 13
99. A.I.R. 1956 S.C. 246.

(Investigation Commission) Act (14 of 1124 M.E.), passed on 7.3.1949, which was in identical terms with Section 5(1) of the Taxation on Income (Investigation Commission) Act (30 of 1947).

The impugned section 5(1) provided that Government might refer to the Investigation Commission before 16.2.1950 for investigation and report any case in which it had prima facie reason for belief that the assessee had, to a substantial extent evaded income tax.

On 26.11. 1949 the Government referred the petitioner's case under section 5(1) of the Act for alleged evasion of tax for the years 1942-1943. Before the Commission could, however, make its report, the Constitution of India came into force on 26.1.1950. Thereupon the petitioner moved the Court for the issue of an appropriate writ, restraining the Commissioner from proceedings in the matter. It was contended that the impugned provisions were void for repugnancy by Article 14, inasmuch as it was discriminatory in the sense that the procedure provided therein was more onerous as compared with that provided under section 47[1] of the Travancore Income Tax Act (23 of 1121), when both dealt with the same class of persons.

Their Lordships rejected the petitioner's contention and held that the two provisions were mutually exclusive and provided different treatment for cases different in their nature and magnitude. It was held that section 5(1) of the

1. Section 47 of the Travancore Act was similar to that of Section 34 of the Income Tax Act, 1922, as it stood before the amendment in 1948.

impugned Act provided for investigation of only those substantial evasions of income tax by persons who had made huge profits during the war and whose cases required special treatment by reason of the large scale evasions during that period. Bhagwati J., speaking for the Court, rightly said:

> "The object sought to be achieved by the impugned piece of legislation is quite definite and that is to catch substantial evaders of income tax out of those who have made huge profits duting the war period. They form a class by themselves and have to be specially treated under the procedure laid down in the Act. Being a class by themselves, the procedure to which they are subjected during the course of investigation of their cases by the Commission is not at all discriminatory, because such drastic procedure has a reasonable nexus with the object sought to be achieved by the Act and therefore such a classification is within the constitutional limitations[2]"

It may be noted that the Supreme Court's attitude in Thangal's case was more realistic and helpful in grappling with tax evasion. But the Supreme Court could not resist the temptation of striking down a similar provision in M.Ct. Muthiah v. Commissioner of Income Tax[3] on the ground that it violates the right to equality. Despite their decision in Thangal's case, their Lordships (by a majority) held that section 5(1) of the Act 30 of 1947 (which correspondedto section 5(1) of the Travancore Investigation Commission Act) became void when the Constitution came into force for repugnancy to Article 14.

---

2. A.I.R. 1956 S.C. 246 at p.267 (para 71). See 'Indian Constitutional Law', M.P. Jain, (1862), pp. 365,366; M.P. Jain, 'Justice Bhagwati and the Indian Constitutional Law;' 2, J.I.L.I., pp. 34,35 (1959).
3. A.I.R. 1956 S.C. 269.

This led to the winding up of one of the most important institutions designed to check evasion and caused a colossal loss of revenue to the exchequer.

However, it appears that the Supreme Court has abandoned its stiff attitude towards anti-avoidance legislation to some extent in its later decisions. For instance, the Supreme Court in Balaji v. I.T.O., Special Circle, Akola[4] upheld the constitutional validity of section 16(3)(a)(i) and (ii)[5] of the Income Tax Act, 1922, which provided that the shares in the profits of a firm received by the wife and the minor children of a partner in the firm should be included in the total income of such partner for the purposes of income tax, as being good legislation.

It was contended that S. 16(3)(a)(i) and (ii) was void for repugnancy to Article 14 of the Constitution, inasmuch as under the impugned sub-section, an individual was taxed on the income of his wife and children, if he carried on business in partnership with his wife or if he admitted his minor sons to the benefits of the partnership, whereas an individual, if he carried on business in partnership with a third party, whether a man or a woman, or even with his major children, or if his wife or children carried on business separately, would be liable only to pay

---

4. A.I.R. 1962 S.C. 123.
5. See Chapter 4, p.179 for text of s. 16(3)(a)(i) and (ii).

tax on the share of his partnership income. It was contended that this fact obviously placed an individual affected by the impugned sub-section in a more onerous slab, for the purposes of income tax, than the latter category of persons, because the husband or father had to pay tax at a higher rate on a higher income, than that he would have to pay, if the income of the wife or minor son was taxed separately, the tax being less on the lower slab.

The Court disagreed with the petitioner's contention and held that the classification made by the legislature had a rational relation to the object sought to be achieved, i.e., to prevent evasion of tax, so the provision was not unconstitutional for violation of the right to equal protection of the law under Article 14. The Court further stated that the impugned sub-section did not violate the right to deal with property and carry on business in Article 19(1)(f) and (g)[6] of the Constitution.

The husband contended that as he was made to pay tax on the income of his wife and children, who were in law distinct legal persons, he was deprived of his property by the State. Subba Rao J., speaking for the Court, stated:

---

6. Constitution of India, Article 19(1)(f) and (g) provide:
"19(1) All citizens shall have the right -
...
(f) to acquire, hold and dispose of property; and
(g) to practice any profession, or to carry on any occupation, trade or business."

"...The scope of the provisions of S. 16(3) is limited only to a few of the intimate members of a family, who ordinarily are under the protection of the assessee and are dependents of him... This mode of taxation may be a little hard on a husband or a father in the case of a genuine partnership with a wife or minor children, but that is offset, to a large extent, by the beneficient results that flow therefrom to the public, namely, the prevention of evasion of income tax, and also by the fact that, by and large, the additional payment of tax made or the income of the wife or the minor children will ultimately be borne by them in the final accounting between them. In these circumstances, we cannot say that the provisions of S.16(3) of the Act impose an unreasonable restriction on the fundamental rights of the petitioner under Article 19(1)(f) and (g) of the Constitution."[7]

The Supreme Court, in one of its most recent decisions, Messrs. Jain Brothers v. The Union of India[8], approved of section 297(2)(f) and (g) of the Income Tax Act, 1961, which classified assessees in two groups for the purpose of the imposition of penalty dependent on whether the assessment proceedings were completed (a) before (b) on or after the 1st day of April, 1962 and held to be a valid piece of legislation.

Section 297(2)(f) and (g) of the Act of 1961 states:

"(2) Notwithstanding the repeal of the Indian Income Tax Act, 1922, ...
....

7. Balaji v. I.T.O. A.I.R. 1962 S.C. 123,129, (para 15).
8. A.I.R. 1970 S.C. 778. The Supreme Court has taken a similar stand in C.I.T., Delhi (Central) v. Messrs. Singh Engineering Work (P) Ltd. A.I.R. 1971 S.C. 95,=(1970) 2 S.C.W.R. 95; The Supreme Court in Babulal v. Collector of Customs A.I.R. 1957 S.C. 877, upheld the constitutionality of S. 178A, inserted in the Sea Customs Act (8 of 1878) by S.14 of the Amendment Act (21 of 1955). It was held that S. 178A of the Act, which places the burden of proof that the goods are not smuggled on the accused in whose possession such goods are found does not violate Article 14 of the Constitution.

(f) any proceeding for the imposition of a penalty in respect of any assessment completed before the 1st day of April, 1962, may be initiated and any such penalty may be imposed as if this Act had not been passed;

(g) any proceeding for the imposition of a penalty in respect of any assessment for the year ending on the 31st day of March, 1962, or any earlier year, which is completed on or after the 1st day of April, 1962, may be initiated and any such penalty may be imposed under this Act."

The cumulative effect of clause (f) and (g) is that the assessees whose assessment had been completed before 1st April, 1962, were to be dealt with for the purposes of imposition of penalty under the Act of 1922, while those whose assessment had been completed on or after April 1, 1962, were to be dealt with under the Act of 1961.

It was urged on behalf of the appellant that the impugned provision was violative of Article 14 of the Constitution, inasmuch as it discriminated between two sets of assessees by reference to a date, which had no reasonable relation to the object of legislation, and it depended entirely on the sweet will of the Income Tax Officer whether the assessment was completed before the 1st day of April, 1962 in order to make the provisions of the Act of 1922 applicable in regard to the imposition of penalty. It was further contended that as the penalty provisions contained in the Act of 1961 are more onerous to the assessee than the penalty provisions of the Act of 1922, so the application of the provisions of the new Act to a certain class of assessee while others were dealt with under the old Act, is <u>ultra vires</u>

the Constitution, being discriminatory in nature.

The Court rejected the appellant's contention and held that the classification based on a particular date, i.e., April 1, 1962, for the purposes of imposition of penalty in respect to pending assessment proceedings was not arbitrary or fanciful. It was necessary for the implementation of the Act of 1961 and the disposal of penalty proceedings, to fix a date when the new penalties would come into force and April 1, 1962, was the appropriate date for this purpose, as it was the date on which the Act of 1961 came into operation. Their Lordships approved of the view taken by the Madhya Pradesh High Court in Gopichand Sarjuprasad v. Union of India[9] and the Allahabad High Court in Income Tax Officer A-Ward, Agra v. Firm Madan Mohan Damma Mal[10] that no discrimination was created by enacting S.297(2)(g) of the Act of 1961. It was held that:

> "...The classification made is based on intelligible differentia, having reasonable relation to the object intended to be achieved. The object essentially was to prevent the evasion of tax."[11]

It was further held that the mere possibility that some Officers might intentionally delay the disposal of a case could hardly be a ground for striking down clause (g) as

---

9. A.I.R. 1969 M.P. 220.
10. (1968)70 I.T.R. 293 (All).
11. Messrs. Jain Brothers v. The Union of India A.I.R. 1970, S.C. 778 at p. 785 (para 13).

discriminatory under Article 14 of the Constitution.

The case is important from two points. Firstly, it has set at rest a controversy between the Bombay[12], Gujarat[13], Calcutta[14], Assam[15], Mysore[16] and Allahabad[17] High Courts on the one hand and the Madhya Pradesh[18] Delhi[19], Rajasthan[20] and an earlier case of the Allahabad High Court[21] in regard to the constitutionality of the impugned provision by deciding in favour of the latter. Secondly, the Supreme Court has taken a different attitude from its earlier decisions in Shree Meenkashi Mills Ltd. v. A.V. Visyavantha Sastri[22] and M. Ct. Muthiah v. C.I.T.[23], wherein as stated earlier, the Court held a classification based on time was not valid.

---

12. Shakti Offset Works v. Inspecting Asst. Commissioner (1967) 64 I.T.R. 637.
13. C.I.T. v. Hira Lal Mohan Lal Shah, (1968) 69 I.T.R. 312; D.M. Mansavi v. C.I.T. (1969) 72 I.T.R. 17 (Guj).
14. Narendra Sharma v. I.T.O. unreported case. Case No 213. of 1966, D/- 5.3.1969 (Cal.) Quoted from A.I.R. 1970, All. 620 at p. 633 (para 39).
15. C.I.T., Assam v. Tejpur Automobiles, A.I.R. 1969 Assam 122.
16. S.G. Magovi v. C.I.T., Mysore, (1967) 64 I.T.R. 409.
17. Messrs. Raghu Nandan Prasad Mohan Lal v. I.T.A. Tribunal, A.I.R. 1970 All. 620.
18. Kishan Lal v. C.I.T., M.P., (1967) 64 I.T.R. 285 (M.P.); C.I.T., M.P. v. Champalal Sukhram, A.I.R. 1969 M.P. 72;
19. Messrs Jain Brothers v. Union of India, Civil Misc. Writ 1247 of 1967, D/- 24.2.1969, (Delhi).
20. Messrs. M.P. Indra and Co. v. Union of India, A.I.R. 1965, Raj. 104.
21. I.T.O., A-Ward, Agra v. Firm Madan Mohan Damma Mal (1968), 70 I.T.R. 293.
22. A.I.R. 1955 S.C. 13.
23. A.I.R. 1956 S.C. 269.

CHAPTER IX

CONCLUSION

The study made in the foregoing pages reveals that tax avoidance and tax evasion are widespread and rampant in India;[1] they have retarded the economic development of the country in various ways. The consequences are grave, and far-reaching. They have reduced the yield of taxes, caused an unfair distribution of the burden of taxes and increased pro tanto the load of taxation on the good citizens, who do not resort to such anti-social and criminal activities. The problem is acute. It has not only retarded the industrial, agricultural and commercial progress of the nation, but has also adversely affected social and moral values of society, creating disrespect for the law and the enforcement machinery leading ultimately to frustration among the honest taxpayers.

The study further discloses that no single factor can account for the spread of tax avoidance and tax evasion on such an alarming scale. Many factors are conjointly

---

1. See Chapter 3, pp. 79,80 and Chapter 5, pp. 204-206 and 242 for extent of loss of revenue on account of tax avoidance, tax evasion and delay in payment and realization of taxes.

responsible for this nation-wide malady. Lack of a sound tax policy, frequent amendments of law, complexity of law, inefficient tax administration, lack of integrity in the Income Tax Department, absence of deterrent punishment and prosecution of tax criminals, uneven treatment accorded to taxpayers, low public morale, non-co-operation of taxpayers and the lenient attitude of the judiciary in cases of tax avoidance and tax evasion, are some of the major factors responsible for the growth of tax crimes.[2]

This indicates that the task of tax crime control is a hard one. It needs a constant and concerted effort from all sections of the community before real success can be achieved. There is no magic formula that will eradicate tax crimes. The problem has to be tackled on a number of fronts and many reforms are necessary, if substantial results are to be achieved. A programme of tax crime control requires a multiple approach in order to make it a success.

Preventive, deterrent and reformative measures must be planned and implemented in a sustained and co-ordinated manner. These should include legal, administrative, economic and social measures, a nation-wide

---

2. For causes and effects of tax avoidance and tax evasion, see supra, Chapter 3, pp. 79 to 82 and Chapter 5, pp. 223 to 261.

programme to educate the people in order to inculcate in them a sense of duty to pay their taxes to the State. Besides this the judiciary should change its approach and outlook to tax crimes.

In the preceding chapters an elaborate study of the feasibility of such measures has been made, and appropriate schemes for their implementation have been suggested.

The Indian Income Tax legislation, as stated earlier, suffers from frequent additions, alterations and amendments. This is an undesirable feature of most modern taxation. It must be conceded that the law has to change to meet the needs of the time and changing circumstances, especially in a developing country like India and in particular in the case of Income Tax legislation, which has to take into consideration the interests of different classes of taxpayers. However, frequent changes should be avoided as far as possible, for they engender lack of confidence in the minds of taxpayers, suggest the absence of a sound policy on the part of the legislature and rob the law of that modicum of stability, which is essential to its healthy growth.

The law should be so conceived and drafted as to be easily understood, even by the average taxpayer. Amendments should only be made after consulting experts and the interests concerned. They should not be made in a hurry;

they should be well thought out.

An essential feature of tax crime control is a sound tax policy. Fiscal legislation is not an end in itself but a means to achieve an end. Taxes should be moderate, within the reach of taxpayer's purses and not excessive. Taxation should not go beyond the saturation point; otherwise it will retard economic growth, lead to tax avoidance and tax evasion and discourage the investment in industries necessary for the development of the economy. The object of taxation should be, to create a harmonious relationship between the State's and the individual's interests, to help the economy of the country to grow and to encourage industrial and economic development. Instead of imposing further exorbitant rates of taxes, attention should be directed to suppressing tax avoidance and tax evasion.

A word may be said for the imposition of income tax on 'agricultural income' and on 'receipts of a casual and non-recurring nature'.

In India, the main burden of income tax falls too heavily on a small segment of society, approximately 3 million people,[3] living in the urban and industrial sectors out of a total population of approximately 541 million.[4]

---

3. '<u>Report of the Working Group on The Central Direct Taxes Administration</u>' (1968), Administrative Reforms Commission, para 2.3, p. 10.
4. This is the latest figure according to the 1971 census.

The bulk of the population, nearly 80 per cent, live in villages and agriculture is their main source of livelihood. Land revenue and taxes on agricultural income are within the exclusive power of the States, being items 45 and 46 on List II in the 7th Schedule of the Constitution. The wide definition of 'agricultural income' in the Income Tax Acts cannot be changed, except on the recommendation of the President, given under Art.270 of the Constitution. Though the net proceeds of income tax collections are distributable between the Centre and the State, agricultural income tax cannot be levied under the Income Tax Act, 1961[5]. As most State Legislatures are controlled by agriculturists, it is notorious that the State Legislatures generally do not exercise their taxing powers so as to impose as heavy a burden on the agriculturists as Parliament imposes under the Income Tax Act, 1961[6]

There appears to be no justification for the disparity between the burden borne by the agriculturist and the non-agriculturist, for it cannot be contended that either class has a heavier responsibility for the improvement

---

5. Some of the Indian States have imposed agricultural income tax on citizens in the higher income bracket. These include Assam, Bengal, U.P., Bihar, etc. M.L. Upadhya, Some Legal Aspects of Agrarian Reform in India (Ph.D. Thesis. University of London, 1970, 619-626).
6. The earlier Income Tax Acts also exempted agricultural income from income tax, see Income Tax Act, 1922, s.4(3) (vii), I.T. Act, 1918, S.3(2)(x), I.T. Act, 1886, s.5(1) (a)(b).

of the national economy. If favour is to be shown, it should be to newly established industrial enterprises. As it is, a person employed in industry or commerce or following a profession and earning Rs. 5,000 a year is more heavily burdened than a person drawing Rs. 50,000 a year agricultural income, because even when agricultural income tax is imposed by the State, the rate is lower than that payable under the Income Tax Act.

The agriculturist lobby contends that the tiller of the soil is too poor to be taxed and he must be exempted from assessment to income tax to encourage agricultural development. But the poorer citizens will derive the greater benefit from economic development, so it is only reasonable that they should contribute what they can to finance such development. As has been pointed out by Professor H.C.L. Merillat:

> "It is an economist's commonplace that a developing country, in working its way towards a relatively self-sustaining posture of economic growth, must channel into savings and investment a large part of the gains in income resulting from current growth. In other words, the siphoning off of savings (which must often take the form of taxation of current income) is a necessary element in the capital formation needed for economic development, whether agricultural or industrial, in conditions that avoid serious inflation. Accordingly, if the agricultural sector of the Indian Community is relatively undertaxed,not only will there be unjust disparities in comparison with the urban population and the industrial sector but also the total economic development of the country may be retarded."[7]

---

7. '<u>Land and the Constitution in India</u>', (1970), at p. 81; See '<u>Tax Burden on Indian Agriculture</u>', Ved P. Gandhi, (Cambridge, Massachussetts 1966), International Programme in Taxation.

It may be noted that 'agricultural income tax' is levied in many parts of equally under-developed parts in East Africa and Nigeria.[8] In Japan as long ago as 1870 the revenue from a tax on agriculture accounted for 51.7 per cent of the total tax revenue[9].

Besides causing disparity between the agricultural and non-agricultural sectors and deleteriously affecting the economy, the exemption encourages income tax avoidance and evasion. People invest unaccounted cash and concealed income in purchasing landed property and get exemption from taxation on the earnings of such property.

It is, therefore, high time for agricultural income to be brought within the purview of income tax.[10] But it may be doubted whether the Central Government feels strong enough to take measures, which might induce the agricultural community to withdraw its support. As, at present, the Government enjoys the support of more than 2/3rds of the members

---

8. '<u>Mr. Kaldor's Plan for the Reform of Indian Taxes</u>', Ursula K. Hicks, (1958) 68, The Economic Journal, pp. 160, 163-64.
9. <u>Supra</u> note 7 at p. 82.
10. <u>The Income Tax Investigation Commission 1953-54</u> in Vol.3 paras 10-13, pp. 222, 223, made a suggestion for one uniform income tax levied by the Union of India and proceeds to be divided between the Centre and the States. But the suggestion was not implemented. The Administrative Reform Commission in its <u>Report on Central Direct Taxes Administration</u> (1969), para 7(h) at p. 22, suggested the inclusion of the agricultural income of a person for the purposes of calculating the rate of tax chargeable on his total income.

of the Lok Sabha, it is in a position to sponsor legislature to amend the Constitution, but a proposal to make a change in any of the Lists in the 7th Schedule, such as transferring the power to levy income tax to the Central List, would require, under Art. 368, proviso (2) of the Constitution, ratification by the Legislature of at least one half of the States.

The Centre has long been aware of the unequal fiscal demands made on the urban and rural taxpayers, and has sought means of enforcing a greater contribution from the agriculturists by inventing new taxes. One such was the Wealth Tax, a levy on the capital value of capital assets exceeding a lakh of rupees. As this applied to agricultural property,[11] the agricultural lobby protested and succeeded in inducing the Government to raise the excluded capital to one and a half lakhs for owners of agricultural land. It is the well-to-do agricultural landlords who fight to maintain the status quo and, if income tax were levied on agricultural income, the main burden would fall on them. The poor cultivator who, they say, is too poor to be taxed, would not suffer, because his income would be too low to bring him within the mischief of the Income Tax Act.

---

11. Supra note 7, pp. 99 to 101.

Under the present scheme of taxation, receipts which are of a ' casual and non-recurring nature' are exempt from income tax under section 10(3)[12] of the Act of 1961. This means that income, which is subject to or produced by chance, or is an accidental gain and whose occurrence is not of a regular nature, is not subject to income tax. For example, a prize won in a lottery or a bet on the race course is exempt from tax, being a receipt of a casual and non-recurring nature.

There appears to be no rationale behind such an exemption, though there are obvious difficulties in obtaining information about some such receipts. It seems unjust that a person who has earned by the sweat of his brow Rs. 5,000 in a year is asked to pay tax on it whereas a person who wins 5 lakhs in a lottery or a horse race is not required to pay even a single paisa, on the ground that the gain is a receipt of an accidental nature.

In addition to a substantial loss of revenue, this exemption provides a fertile ground for concealing unaccounted money and evading payment of taxes, as pointed out earlier in Chapter five.[13] A lot of the valuable time

---

12. Section 10(3) of the Act of 1961 provides three cases in which such receipts would be chargeable to income tax. These are:
(i) capital gains, chargeable under the provisions of section 45; or
(ii) receipts arising from business or the exercise of a profession or occupation; or
(iii) receipts by way of addition to the remuneration of an employee.

13. See <u>supra</u> p. 203.

of the Courts', the Revenue authorities and the taxpayer is wasted in finding out whether a receipt is of a casual and non-recurring nature, exempt from taxes.

It may not be out of place to mention that the earlier Income Tax Act of 1886 was more pragmatic in this respect, inasmuch as it did not provide an exemption from income tax in such cases. The Act of 1961 has no doubt limited the scope of the blanket exemption provided in the Act of 1922,[14] but this is not enough.

It would be in the interest of the revenue and taxpayers in general that this exemption, which has no ethical, social or legal justification should be withdrawn.[15]

A large section of the community either does not pay taxes or pays at a very low rate, though their income is much above the minimum taxable limit,[16] and thereby evade paying a substantial amount of tax every year. They

---

14. See supra note 12. Similar provisions regarding exemptions from taxation were contained in the Act of 1922, in section 4(3)(vii) and in the Act of 1918 in Sec. 3(2)(viii).
15. See 'A Plea for Tax on Casual Income', R.N. Varma (1964) Tax Consultant Conference Souvenir (Jaipur) p.137, 149-50.
16 Supra notes 3, 6.11 at p. 112. This is evident from the fact that in the First Voluntary Disclosure Scheme, out of 2,001 persons, 191 persons and in the Second Voluntary Disclosure Scheme out of 2,66,000 persons, 77,030 were those who had not been previously assessed. In India only 1 per cent of the income earning population pay income tax, whereas in Britain 70 per cent of (the income earners) pay taxes. See 'Indian Tax Reform', Nicholas Kaldor (Government of India, 1956, p. 7.

include persons belonging to such professions as contractors, accountants, doctors, lawyers and traders. Such persons generally do not keep any record or account of their income or they do business not recorded in their account books.

An extensive door to door survey is needed to bring to book such persons. Assistance of persons living in the locality may be of use in ascertaining the income, expenditure and the standard of living of such individuals in order to determine the actual income for the purposes of taxation.

Perhaps, it would be appropriate to establish a separate unit for the purpose in every Commissioner's division. The present staff is inadequate for the purpose and should not be trusted with this work. A team of enthusiastic and well trained staff is needed for the purpose.

A system of rewards to informers may be introduced, as in case of the United States of America and the United Kingdom. This system is enforced by the Indian Customs Department.

All persons doing business or following professions could be required by law to keep accounts of their income and expenditure and failure to do so should attract penalty.[17] To start with, this might be made compulsory in the case of persons having an income of Rs.25,000 per annum.

In the case of contractors and landlords (who earn a huge sum of money in rent from houses and other properties in cities), the tax could be deducted at source, as in the case of the salaried class of people and paid direct to the Government by the person making such payment.

In case of husband and wife, the income should be added for the purposes of taxation as is done in Britain. This will close one of the areas of evasion, inasmuch as the husband will be restrained from misrepresenting part of his income as that of his wife and claim exemption from taxation.

The accounting year should be the same for every one for purposes of taxation. At present it is open to an individual taxpayer doing business to adopt any date, depending on his own convenience as the end of the previous year for the purposes of assessment of tax. This creates a lot of confusion and makes the procedure for assessment cumbersome and complicated so that much of the Department's time is wasted.

---

17. The Sales Tax statutes of various States make provision for keeping accounts and records. Failure to comply with the statutory provisions leads to statutory punishment. See The Bombay Sales Tax Act, 1946, S.24(1)(e); Punjab General Sales Tax Act, 1949, S.23(1)(e); The Bihar Sales Tax Act, 1947. S.16; The Madhya Pradesh Sales Tax Act, 1947, S. 24(e); Similar provisions are contained in the United States in U.S., Internal Revenue Code, 1954, section 6001; In New Zealand, The Land and Income Tax Act 1954, S.239; In Canada, the Income Tax Act, 1952, S. 131(2).

The return forms meant for assessees with incomes above Rs. 15,000 per annum and for companies, which runs into 30 pages, should be simplified, as has been done in the cases of other assessees. The form should be simple and easy to understand. An instruction as to how one should fill in the return form should be attached to the form; this will help a taxpayer to understand the provisions and make a correct return.

A word may be said regarding collection of taxes. A substantial sum of Government money is lying in the hands of taxpayers. To extract this requires a herculean effort on the part of the Government and the Income Tax Department. Special endeavours are required for the purpose.[18] Arrangements should be made in the Income Tax Department for the collection of taxes. Under the present system a taxpayer is required to deposit the amount of tax either in the State Bank or a Government Treasury, which stops collection after 2 p.m. on week days and 12 o'clock on Saturday. A taxpayer is first required to go to the Income Tax Office and, after taking a chalan (voucher), he is required to deposit the sum in the State Bank of India or the Government treasury. This takes up a lot of the

---

18. See 'The New System of Collecting Income Tax, Property Tax and Company Tax in Indonesia', D.R.S. Muhid Husni, (1969) 23, Bulletin for International Fiscal Documentation, pp. 151-9.

assessees' time and he is put to much inconvenience. It would be better if a provision were made for the collection of taxes in the departmental office, which should remain open until 5 p.m. This will facilitate the timely collection and save the assessee's time.

A rebate, 5 to 10 per cent of the tax due, as is prevalent in the case of electricity charges should be given to these taxpayers who deposit taxes within a prescribed time and failure to do so should automatically forfeit the amount of rebate. This would go a long way in accelerating the system of collection of taxes. This system is working very well in the case of the Electricity Department and should be tried by the Income Tax Department.

The importance of educating the taxpayer cannot be too heavily stressed in modern times, when almost every one has to pay tax in one form or the other. Such education is necessary to create the proper psychological approach and inspire confidence in the average taxpayer.[19]

Taxpayers should be properly informed and given every assistance by the Income Tax Department. The Department should send the necessary literature to individual taxpayers along with the return forms. Information should be issued on radio, television and in the press; taxpayers should be reminded of the dates for

---

19. See Articles on '<u>Tax Payer's Education</u>', F.H. Vallibhoy, B. Venkataratnam and Onkar Nath, 'Report on 3rd All India Conference of Tax Executives (1968), pp. 125-30, 131-36 and 137-39 respectively.

filing returns well in advance. Model returns should be prepared and explained to the taxpayers. Offices should be open during hours when taxpayers are not usually working, so that taxpayers can contact the officers and get their difficulties solved.

Taxpayers should be amde to feel that what they are paying in taxes is fair and just and that they are making a valuable contribution to the State. The taxpayers should be told that the act of defrauding the revenue is a mean and despicable offence against his fellow taxpayers and should not be done in any circumstances.

There is perhaps no other field of state and citizen relationship in which it is as necessary to have a cordial co-operative and smooth relationship and attitude as in the case of taxation. The Department should encourage the co-operation of the assessees and the assessees should reciprocate with the same spirit of cordiality, so as to pave the way for the harmonious relationship essential for a successful programme of taxation.

An important step in crime control is the infliction of deterrent punishments; this is necessary, not only to deter others from committing such crimes, but also to raise the standard of morale of the people. But unfortunately no attention is paid to this in India by the Income Tax Department. Generally a nominal monetary penalty is imposed or a half-hearted attempt is made to institute criminal prosecutions against tax evaders, which result in acquittal.[20]

This has had a demoralizing effect on the taxpayers as a whole and gives an incentive to tax evasion. The Department should change its lenient attitude and resort to more deterrent methods. Tax avoidance and tax evasion will stop only if the cost of avoidance or evasion is higher than the gain out of it.

A successful programme of deterrent punishment should include provisions for automatic civil penalties, criminal prosecution, economic and social sanctions.

In cases where taxpayers fail to fulfil their statutory obligations to file a return of income within a prescribed time or pay taxes as required by the provisions of the Act, without any reasonable cause or excuse, an automatic penalty should be added.[21]

The efficacy of a jail sentence is beyond question[22]. Such a sentence, "has had a most benign effect on those who

---

20. See Chapter 5, p. 229.
21. '<u>Report of the Seminar on Administration of Income Tax in African Countries</u>, United Nations, (March 25 to 5th April, 1968), p. 13.
22. In Israel a successful campaign of prosecution of tax evaders during a short period of three years 1961-64 increased the amount of declared income by 150 to 200 per cent as compared with returns filed before sentences were inflicted. See '<u>Memorandum: Criminal Proceedings For Income Tax Offences</u>', Director of State Revenue, March 3, 1965, p. 7; '<u>The Crime of Income Tax Fraud: Its Present Status and Function</u>'(1953) 53, Col. L.R. 476, 478.

do not like to pay taxes."[23] But in India provisions relating to penalties and prosecutions are more or less a dead letter and rarely applied.

As stated earlier,[24] the prosecution machinery should be strengthened; tax evaders should be prosecuted in large numbers every year and publicity should be given to such cases in the press. Compromise of cases of tax evasion should be discouraged. It would be better to delete the provisions relating to compromise contained in section 279(2) of the Act of 1961.

The offence of making a false statement in a declaration under section 277[25] of the Act of 1961, should be made cognizable and non-bailable. This would have a great deterrent effect and people would think twice before making false and fraudulent statements in their returns of income.

Accountants, tax consultants and Officers of the Income Tax Department, who co-operate in tax avoidance and tax evasion, should also be prosecuted and punished adequately. This will have a positive and healthy effect both on the working of the Income Tax machinery and the taxpaying community in general.

---

23. '<u>After Sentence - What</u>?' James V. Bennett, (1954-55) 45, Journal of Criminal Law, Criminology and Police Science, North Western University School of Law, p. 537.
24. See Chapter 5, pp. 226-32.
25. See Chapter 7, <u>Supra</u> p. 339 for text of section 277.

A person found guilty of evasion of taxes or non-payment of taxes should be debarred from entering into Government contracts, obtaining foreign exchange, leaving the country, obtaining an import licence, seeking elections for Parliament, State legislatures and local bodies. Such persons should be made social outcasts and Ministers and Government officials should be restrained from attending parties given by such people,[26] and associating with them.

A word of caution may be added here. While the severity of penalties and the likelihood of conviction are important factors in minimizing the incidence of tax evasion, the psychology of the average tax offender, the cost and convenience of administration, the amount of loss to the revenue, and the danger of harm to innocent persons should also be taken into account before launching a prosecution.

The magnitude of tax avoidance and tax evasion is directly linked with the judicial attitude. If the Courts' attitude is favourable to a taxpayer seeking to avoid and evade the taxes, these activities will obviously flourish.

In India, as noted earlier,[27] the Courts' attitude has always been encouraging to the reluctant taxpayers. The Courts have approved of schemes and devices of a

---

26. *Supra* note 3, para 6.43 at p. 129.
27. See Chapter 4.

taxpayer meant to defeat the object of the fiscal legislation and escape from the impact of taxation, ignoring the social and economic effect of the decisions. The Courts in India, like British Courts, have applied the principle of strict interpretation of statutes, when deciding cases relating to tax avoidance, even when it has led to absurd results and have expressed their inability to remedy any defect in the legislation.[28]

It is submitted with respect, that the Courts' view on the point needs modification in the light of changed circumstances and conditions. The Courts should not blindly follow and apply the literal rule of interpretation, or maintain ancient traditions, ignoring the social and economic interests of the community. The Courts' role, as stated by Lord Denning, M.R.[29], should not be to defeat the object of legislation but to promote it by giving a liberal interpretation of the provisions. This is particularly necessary when interpreting the provisions of economic legislation like an Income Tax Act, the object of which is to promote the economy of the Country. The view expressed by Hedge J., in V.D. Dhanwatey v. C.I.T., M.P.[30] (minority

---

28. See Chapter 4, p.148 ; see 'Around the Courts', G. McGregor (1968) 16 Can. T.J. 262-280; Interpretation of Taxing Statutes: Whither Canada? G. McGregor (1968) 16 Can. T.J., pp. 122-136.
29. See Chapter 4, pp.
30. A.I.R. 1968 S.C. 683.

judgement) in regard to the interpretation of ancient texts equally applies in case of economic legislation. He states:

> "Law is a social mechanism to be used for the advancement of the society. It should not be allowed to be a dead weight on the society. While interpreting ancient texts, the Courts must give them a liberal construction to further the interests of the society."[31]

The Courts should interpret a taxing statute fairly and equitably, in such a way as to give effect to the intentions of the legislature and not to defeat it. The Courts should also have due regard to the true nature and effect of the transaction under consideration and take into account its social, economic and legal effect. The role of Courts in India, like that of the Supreme Court of America[32], should be to accelerate the wheels of the legislature in its efforts to root out such anti-social acts and not to give encouragement to tax evaders.

Another important area in which the Courts' role is significant in checking tax evasion is the application of the penal provisions contained in the Income Tax Act.

The Courts' attitude, as elsewhere, has been discouraging from the point of view of the revenue. This is evident from the fact that, out of 31 prosecutions launched by the Income Tax Department for tax evasion during

---

31. Ibid. p. 696 (para 31).
32. See Chapter 4, supra pp.193-98.

the years 1961-62 to 1965-66, the Courts convicted in only two.[33] No doubt, the Income Tax Department is responsible to a great extent for the acquittals. Nevertheless, the Courts' attitude towards such criminals is material and important from the point of view of checking tax crimes in the Country. The lenient attitude of the judiciary towards economic offences is a direct inducement to potential violators and others to indulge in such crimes.

The mild attitude towards tax evaders is again discernable from the fact that the Courts, when dealing with administrative penalties, apply the Common law doctrine of *mens rea*, even in cases where the legislature has purported to do away with it.

Showing a soft or sympathetic attitude in cases of glaring tax evasion is inappropriate in a developing country like India.

It may be appropriate here to quote an extract from the judgement of the Court of appeal in *R. v. Daher*,[34] which illustrates the value of the infliction of deterrent punishment in economic offences. The Court upheld a sentence of three years imprisonment on a Lebanese student of nineteen, for illegal importation of cannabis.

The accused, previously of good character had been induced to become the "runner" of some Lebanese drug

---

33. See Chapter 5, pp.228-9 and Chapter 8, pp. 428-50.
34. (1969) 53 Cr. App. Rep. 490; see '*The English Sentencing System*', Rupert Cross (1971), p. 107.

exporters by the promise of money and a short holiday visit in Britain. He was found to have £3,500 worth of cannabis on his arrival in Britain.

The Court refused to take a lenient attitude and reduce the penalty to a suspended sentence of six months, as in other cases, on the ground that:

> "... If a young man such as the appellant is given a six months' suspended sentence, back he goes from whence he came, and the news spreads like wildfire amongst all students. 'Well, this is not a bad way of trying to get money, because if it comes off, you have made a nice profit and had a good holiday, and if it does not come off you will just be sent home again.' On the other hand, if it is known among potential runners in the Lebanon, and elsewhere, that if they are caught attempting to smuggle the drugs into this country they will be very severely dealt with, there may be a remarkable lack of enthusiasm for enterprises of this kind and great difficulties put in the way of people who run this horrible trade."[35]

This attitude alone, can help in eradicating tax evasion. The Courts should not hesitate in awarding long term prison sentences for tax crime cases. The best way to prevent tax fraud is to impose heavy terms of imprisonment on delinquents. The taxpayers should be taught by criminal prosecution that attempts at concealment of income will not only fail but also land him in jail.

---

35. Ibid. at p. 492; see '<u>Criminal Sanctions in Economic Law</u>', J. Unger; Published in British Legal Papers, (4th August-9th August, 1958), pp. 383-389; '<u>Nature of Criminal Law and Criminal Proceedings: Mens Rea and Economic Crimes</u>, Latika Sarkor and R.V. Kelkar (1965) 7, J.I.L.I. pp. 456-462: <u>Mr. Justice Gajendragadakar on Criminal Law</u>, Girsih Chandra (1966) 8 J.I.L.I., p. 588,596.

APPENDIX

ORGANIZATION CHART
DEPARTMENT OF REVENUE AND EXPENDITURES
MINISTRY OF FINANCE
GOVERNMENT OF INDIA

HEAD QUARTERS

MINISTRY OF FINANCE

Department of Revenue
and Expenditures

Central Board of Indirect Taxes (includes Customs and Excise).

Central Board of Direct Taxes. (5 members).

Directorate of Inspection

FIELD

Commissioner of Income Tax

Appellate Assistant Commissioner

Inspecting Assistant Commissioner

Income Tax Officer

Inspector of Income Tax

(Chart has been taken from the Report on Tax Administration in India - A Tax Assistance Survey, By Foreign Assistance Staff, United States Internal Revenue Service, (1964) at p.8.).

TABLE OF CASES

*/ 1959 Bom. 448.

C.I.T. v. Raman & Co., A.I.R. 1968 S.C.49	67,150,157, 393
C.I.T. v. Ramkrishna Deo, A.I.R. 1959 S.C. 239	149, 480, 481-83
C.I.T. v. Ramniklal, A.I.R. 1969 S.C.862	172
C.I.T. v. Rayalaseema Oil Mills, A.I.R. 1971 A.P. 34	306, 316
C.I.T. v. Remington Typewriter Co., Ltd., A.I.R. 1931 P.C. 42	186
C.I.T. v. Rupsa Rice Mills, (1964) 54 I.T.R. 328 (Orissa)	288
C.I.T. v. Angdi Chettiar, A.I.R.1962 S.C. 970	291, 300
C.I.T. v. Sarangpur Manufacturing Co., (1938) I.T.R. 36 (P.C.)	257
C.I.T. v. Saroja Mills, A.I.R. 1967 S.C. 819	159-61
C.I.T. v. Satyanarayanamurthy, A.I.R. 1965 A.P. 95	92
C.I.T. v. Shazadanand & Sons,(1966) 60 I.T.R. 392 (S.C.)	148,149
C.I.T. v. Shaw Wallace & Co., A.I.R. 1932 P.C. 138	38
C.I.T. v. Sheikh Abdul Kadir, 2 I.T.C. 372	296
C.I.T. v. Singh Engineering Works, A.I.R. 1971 S.C. 95	507
C.I.T. v. Sodra Devi, A.I.R. 1957 S.C.832	148, 178-80
C.I.T. v. Srinivasan & Gopalan, A.I.R. 1953 S.C. 113=(1953) 23 I.T.R. 87	48, 325
C.I.T. v. Teja Singh, A.I.R. 1959 S.C.352	275,291,324,330-32
C.I.T. v. Tejpur Automobiles, A.I.R. 1969 Assam 122	291, 510
C.I.T. v. Ukhera Estate, A.I.R. 1971 Cal 125	475
C.I.T. v. V.V.Venkatamiah, A.I.R.1943 Mad. 579	316

Pryce v. Manmouthshire, (1879) A.C. 197	128, 129
Punjabhai Dipchand v. C.I.T., A.I.R. 1949 Bom. 415	150, 154, 155 156, 162
Purshottam Govindji Halai v. B.M.Desai, A.I.R. 1956 S.C. 20	14, 15, 68 70, 442
Purshottamdas Thakurdas v. C.I.T., Bombay, A.I.R. 1963 S.C. 1066	264, 269, 273
Queen v. Chait Ram, (1870) 2 N.W. 113	348-49, 351
Queen v. Mudheo Dutt, (1884) 14 W.R. 71 (Cal)	341,348,351
Queen v. Roland Bertrand, (1967) 67 D.T.C.5245	227
Queen v. Smith, (1958) 58 D.T.C. 1125	374
R v. Barree Ltd. (1947) 18 Can. Cr.Cases 397	418
R v. Bell, (1925) Can. Cr. Case 253	374
R v. Botha, (1960) 4 S.A. 6 (T)=24 S.A.T.C. 22	376-77
R v. Bradbury, (1921) 1 K.B. 562	424
R v. Caron, (1948) 91 Can Cr. Case 389	369-71
R v. Daher, (1969) 53 Cr. App. Rep. 490	531-32
R v. Dayalji Enderji, (1871) 8 B.H.C.R. 21(Cr.C.)	421
R v. Donen, (1925) 1 D.L.R. 1141	374
R v. Edlin, (1921) 1 K.B. 562	424
R v. Harrison, (1924) 3 D.L.R. 312	372
R v. Haumann, (1909) 73 J.P. 516 (C.C.A.)	450
R v. Hood-Barrs, (1943) 1 K.B. 455	424
R v. Hudson, (1956) 2 Q.B. 252	424-25
R v. Kritz, (1950) 1 K.B. 82	472
R v. Lamothe, (1958) 119 Can. Cri. Case 330	371-72
R v. O'kelly, (1924) 3 D.L.R. 312	372
R v. Regerr, (1967) 3 Can. Cri. Case 68	400
R v. Smith, (1958) 120 Can. Cri. Case 241	374-75, 469
R v. Summers, (1952) 1 All E.R. 1059	472

TABLE OF STATUTES

INDIA: CENTRAL STATUTES

Year	Name of the Act	Section(s)	Page(s)
27 of 1940	The Agricultural Produce Cess Act.	Referred	23
21 of 1947	The Business Profit Tax	" "	31
4 of 1924	~~The Ce~~ntral Board of Revenue	" "	43
1 of 1924	The Central Excise and Salt Act	3,17,24 and 27	345
64 of 1956	The Central Sales Tax Act	10,10A	345
5 of 1908	The Code of Civil Procedure	2(11)	337
14 of 1923	The Cotton Cess Act	Referred	23
5 of 1898	The Criminal Procudre Code	345	415,481
		439	348
34 of 1953	The Estate Duty Act	Referred	25
1 of 1872	The Evidence Act	101-104	473
		103	472
	" "	106	476
15 of 1940	The Excess Profit Tax	Referred	25
		5	155
	" "	10A	155,156
1947	The Excess Profit Tax (Amendment) Act	12B	182
29 of 1957	The Expenditure Tax	Referred	25,33
	" "	17	345
		32	345
18 of 1958	The Gift Tax Act	Referred	25,33
		2(xxiv)(d)	92
	" "	17	345
		35	345
32 of 1860	The Income Tax Act	Referred	27
9 of 1869	The Income Tax Act	" "	279
		24	349
	" "	25	262,341, 348-9,355

The Income Tax Act, 2" of 1886

The Income Tax Act, 7 of 1918

The Income Tax Act, 11 of 1922

The Income Tax Act,43 of 1961

Year	Name of the Act	Sections	Page(s)
7 of 1917	The Income Tax (Amendment) Act	Referred	347
21 of 1930	" " "	"	108
7 of 1939	" " "	"	30,317
11 of 1944	" " "	"	268
58 of 1948	" " "	34(1)	500
15 of 1953	" " "	Referred	31
13 of 1963	" " "	"	317
1 of 1965	" " "	"	211
27 of 1967	" " "	"	266
1962	The Income Tax Rules	117 A	267
45 of 1860	The Indian Penal Code	21	412
	" " "	107	407
	" " "	109	408
	" " "	166	414
	" " "	177	395,398,416 422-24
	" " "	182	404
	" " "	193	404,406
	" " "	196	404,406
2 of 1899	The Indian Stamp Act	62-72	345
1950	The Finanace Act	13(1)	439-40
15 of 1955	" "	Referred	210
18 of 1956	" "	"	266,410
5 of 1964	" "	40 "	289,333,413
[illegible] of 1968	" "	19	290
14 of 1969	" "	12,15-6, 22	269,271-2, 274,326,399
19 of 1970	" "	Ref. [illegible]	89
24 of 1930	The Indian Lac Cess Act	Referred	23
8 of 1878	The Sea Customs Act	167-68	345
	" "	178 A	409

State: Statutes

Year	Name of the Act	Section	Page(s)
19 of 1947	Bihar Sales Tax Act	16	522
2 of 1876	Bombay City Land Revenue Act	13	442
5 of 1946	Bombay Sales Tax Acts	24(1)(e)	552
2 of 1959	M.P.General Sales Tax Act	24(e)	522
2 of 1864	Madras Revenue Recovery Act	46	441
46 of 1948	Punjab General Sales Tax Act	23(1)(c)	522
14 of 1124 M.E.	Travancore Taxation on Income (Investigation Commission) Act	5(1)	502-504
		47	503
2 of 1916	U.P.Municipalities Act	4(b)	16
	" "	293	16
	" "	298	16

Other Countries

AUSTRALIA

Income Tax and Social Service Contribution Assessment Act 1936-1969

Sections	Page(s)	Sections	Page(s)
222-51	343	223	358
224	358	225	358
226	280	227	280
227-31	394	230	280,361
231	280	237	457-58

BRITIHS GUIENA

Income Tax Ordinance (C 29) 1953.

48(4)	54

CANADA

Income War Tax Act, 1917

Special War Revenue Act, 1927

Income Tax Act, 1948

Income Tax Act (R.S.C. 1952 C 148)

GAMBIA

Income Tax Ordinance 27 of 1948

NIGERIA (and LAGOS)

Companies Income Tax Act 22 of 1961

NEW ZEALAND

Land and Income Tax Act 67 of 1954

B I B L I O G R A P H Y

Books, Articles, Comments and Notes.

Aiyar, A.N., Aiyar, S.V. and Rajopal, T.P. The Indian Income Tax Act, 1922., 7th ed., Madras: Company Law Institute, 1950.

Aiyar, A.S. Natraja, 'The Juristic Personality of Deities in Hindu Law', (1954) 3, Vyavhara Nirnaya, p.3.

Aiyar, T.V. Viswanath, 'Taxation of Charities, and Trusts'. (1963), Lawyer, 321.

Angell, B. 'Tax Evasion and Tax Avoidance', (1938) 38, C.L.J. p.80.

Balter, Harry Graham, Tax Fraud & Evasion, 3rd ed., New York: (Ronald Press Co., 1963).

Banerjea, P. A History of Indian Taxation, London: Macmillan and Co., 1930.

Basu, D.D. Commentary on the Constitution of India. (Vol.IV, 5th ed.), Calcutta: Sirkar & Sons, 1968.

Bennett, James V., 'After Sentencing?' (1954-55)45, J.C.C.P.S. 537.

Bhagat, B.R., 'Inaugural Address', 1st All India Conference of Tax Executives, F.I.C.C.J.I.J. p.1.

Bijawat, M.C. 'Tax Spring: An Instrument to Retain and Attract Foreign Capital',(1964) 6, J.I.L.I. p.236

Birla, L.R., 'Welcome Speech',2nd All India Conference of Tax Executives, (1967) F.I.C.C.I., p. 1.

Bose, A.K. 'Deduction of Tax at Source', 4th All India Conference of Tax Executives, F.I.C.C.I. p.173,

Buchwald, 'Collateral Estoppel Applied to Civil Fraud Penalty',(1965) 19 U.M.L.R. p.672.

Challoner N.E. and Greenwood, J.M. Income Tax Law and Practice,(1962, with supplement 2nd ed.), Australia Law Book Company, 1969.

Chandra, Girish, 'Mr. Justice Gajendra Gadkar on Criminal Law', (1966) 8 J.I.L.I. 588.

Chawala, O.P.,'Development of the Concept of Income Under the Indian Income Tax Laws (1860-1967), (1968) 22 B.I.F.D. 343.

Chitaley, V.V. and Appa, Rao,'The A.I.R. Commentaries: The Constitution of India', 1st ed. Vol.III. Nagpur: The All India Reporter Ltd. 1956.

Chommie, John, 'The Law of Federal Income Taxation', Miami, West Publishing Company. 1968.

Cochran, Howe P., 'Tax Avoidance Schemes End in Disaster', (1951) 5, Miami, L.Q. 435.

Cooley, Thomas McIntyre, The General Principles of Constitutional Law in the United States of America, (3rd ed. by Andrew C. McLaughlin), Boston, Little, Brown, 1898.

Coutts, J.A., '<u>Standards of Proof in Divorce Court</u>, (1951) 14 Mad. L.R.41.

Cross, Rupert, '<u>Evidence</u>, 3rd ed., London, Butterworths 1967.

______ '<u>The English Sentencing System</u>', London: Butterworths, 1971.

Cruz, Roman A., '<u>Obstacle to a Revenue Administration in the Phillipines</u>, (1969) 10, The Tax Monthly 13, (Phillipines.)

Dalal, R.K., '<u>Tax Avoidance in India</u>', (1953) 7, B.I.F.D.,p.1.

Derrett, J., Duncan, M., <u>A Critique of Modern Hindu Law,</u>' Bombay: N.M. Tripatin, 1970.

______ <u>An Example of Tax Evasion in Medieval India</u>, (1947) 19, B.S.O.A.S. 164.

______ '<u>Acquisition of Joint Family Property and Recent Decisions of the Supreme Court</u>', (1969) 1 S.C.W.R. 25 = (1969) K.L.J.R. 37.

______ '<u>Acquisition of Joint Family Property; How the Presumptions Operate</u>'. (1967), Bombay L.R.J., p.1.

______ '<u>Acquisition of Joint Family Property Through a Coparcerner: Let Sastric and Equity Principles Join Hands</u>', (1969) 71, B.L.R.J. 71.

______ '<u>Law and The Predicament of the Hindu Joint Family</u>', The Economic Weekly, (Feb.13, 1960), p. 305.

______ '<u>The Relation Between Social and Economic Development of Society and the Development of Law: Hindu Law in India</u>; (1970) A.I.R. Jn.1.

Derrett, J., Duncan, N., '<u>The History of the Juridicial Framework of the Joint Hindu Family</u>. Contribution to Indian Sociology. No.6. (S.O.A.S., University of London), Mountain & Co. 1962.

______ <u>The Liabilities of Deities to Pay Taxes</u>, (1969) 71 Bom. L.R., 38.

______ '<u>The Supreme Court and Acquisition of Joint Family Property</u>', (1960) 62, B.L.R.(Jn) 57.

______ <u>The Supreme Court and the Acquisition of Joint Family Property</u>, (1971) 1 S.C.W.R., 7.

Diskerson, Robert W.,'<u>The Use of Trusts and the Company for Tax Avoidance in Canada, the United States of America and Great Britain</u>. (Ph.D. Thesis, University of London) 1965.

Downing, R.L.,'<u>Taxation in Australia: Agenda for Reform</u>.' Melbourne University Press, 1964. Melbourne.

Duke, Stevens, '<u>Prosecution for Attempts to Evade Income Tax - A Discordant View of a Procedural Hybrid</u>'. (1964) 76 Yale L.J. p.1.

Dworkin, Gerald,'<u>Odger's Construction of Deeds and Statutes</u>' 5th ed., London: Sweet & Maxwell 1967.

Eapenn, Jacob, '<u>Incidence of Tax Evasion</u>'. 2nd All India Conference of Tax Executives, (1967) F.I.C.C.I. 7.

Einstein, Louis, '<u>Some Iconclastic Reflections on Tax Administration</u>'. (1945) 58 Harv. L.R. 477.

Elliot, Sheldon D, '<u>Statutory Interpretation and the Welfare State</u>'. (1959-60) J.I.L.I. 2.

Eugena, Francis, '<u>Introduction to Income Tax Law: Canada</u>', C.C.H. Canadian Ltd. 1955.

Findley, G. Shirras and Rostal, L., '<u>The Burden of British Taxation</u>'. The National Institute of Economic and Social Studies II, Cambridge University Press, 1942.

Ford, H.A.J., '<u>Legislation Against Tax Avoidance: The Australian Experience</u>', (1961) B.T.R. 247.

Francis, J. Balter, '<u>Income Tax Fraud - Basic Principles for the General Practitioners</u>', (1956). Oreg. L.R. 37.

Fransworth, A., '<u>Legal Evasion of Taxation</u>'. (1944) Mod. L.R. 84.

Freeman, Harrob A. and Kirshner, Lewis H., '<u>An Ounce of Prevention: A Study of Corporate Tax Avoidance</u>'. (1946) 46 Col. L. R. 953.

Friedmann, W., '<u>Law in a Changing Society</u>'. London: Stevens and Sons, Ltd. 1959.

Gae, R.S., '<u>Penalty Provisions Under the Income Tax Act and Wealth Tax Act: Legal Aspects of Implications and Justification of Recent Changes</u>.' (1968), F.I.C.C.I. 103.

Geddie, William (ed.), <u>Chambers's Twentieth Century Dictionary</u>, revised ed. London: W. and R. Chambers Ltd. 1968.

Gerald, L. Wallace, '<u>Penalties and Prosecutions for Evasion of the Federal Income Tax</u>,'(1946), 1, Tax Law Rev. 329.

Gledhill, Alan, '<u>Constitutional Protection of Life and Liberty</u>' (Patna Law College Golden Jubilee Commemoration Volume). Bombay: Asia Publishing House. 1961.

______ '<u>Republic of India</u>', (2nd ed.) London: Stevens and Sons, 1964.

______ '<u>Life and Liberty in India</u>', Vol. 2, (1959-60).2, J.I.L.I. 241.

Gorden, Emanne L., '<u>Income Tax Penalties</u>', (1944) 5 Tax L.R. 131.

Gorden, Myron L., '<u>Fraud in Federal Income Tax</u>', (1948) 32 Marq. L.R. 120.

Goswani, P. '<u>Criminolgy</u>', Kitab Mahal (Allahabad) India.

Grazia, Edward D., '<u>Crime Without Punishment: A Psychiatric Conundrum</u>'. (1952) 52, Col. L. Rev. 746.

Groves, Harold M. and Selle, Arthur M., '<u>Fraud and Federal Income Tax</u>'. (1953) 7, B.I.F.D. 235.

Gulati, I.S. and Gulati, K.S., '<u>The Undivided Hindu Family! Its Tax Privileges</u>'. Bombay: Asia Publishing House, 1962.

Gunn, J.A.L., '<u>Gunn's Commonwealth Income Tax Law and Practice</u>' 6th ed., Sydney: Butterworths, 1960.

Gutkin, Sydney A., '<u>Tax Avoidance v. Tax Evasion</u>'. Ronald Press Company, Ltd.

Haughton, G.C., 'Institute of Hindu Law and the Ordinances of Manu'. London: Cox and Baylis, 1825. (Translated)

Hirot-Lorenzen, S., 'The Situation in Denmark'. (1953) 7, B . I.F.D. 10.

Horror, W.H., 'Trust in the United States: Entity in Federal Income Taxation'. (1940-41) 25, Minn. L.R., 189.

Horner, W.J., 'Tax Reform which could be Worked'. 'The Guardian', December 9, 1969.

Husni, D.R.S.Muhid, 'The New System of Collecting Income Tax, Property Tax and Company Tax in Indonesia'. (1969) 23, B.I.F.D. p.155

Ileric, A.R.,'Tax Evasion and Avoidance', (1954) II, Can. T. J. 357.

Irani, P.K., 'The Courts and the Legislature in India'. (1965) 14, I.C.L.Q. 950.

Jain, M.P., 'Indian Constitutional Law', Bombay, N.M. Tripathi, 1962.

______ 'Justice Bhagwati and the Indian Constitutional Law', (1959) 2 J.I.L.I. 34.

______ 'Power of Search and Seizure', (1969) 11, J.I.L.I.

Jain, S.N.'The Best Judgement Assessment Under the Indian Sales Tax Law', (1965) 7, J.I.L.I.82.

Jaitly, P.N. 'Deduction of Tax at Source'. 4th All India Conference of Tax executives (1969), F.I.C.C.I. 190 .

Jay, Rt. Hon. Douglas, 'Labour and Tax Reform' (1957), B.T.R. 160.

Jenkins, Peter J.H., '<u>Tax Reform Proposals in New Zealand</u>.' (1968) 16 Cam. T.J. 149.

Johnson, Harry G., '<u>Self Assessment Personal Income Tax: The American System</u>. (1971) B.T.R. 78., (1970) B.T.R. 28

Kabra, B.L., '<u>Advance Payment of Tax</u>', (1969) 4th All India Conference of Tax Executives F.I.C.C.I p.177

Kaldor, Nicholas, '<u>Indian Tax Reform: Report of a Survey</u>.' Government of India, 1965.

Kanga, J.B. and Palkhiwala, N.A., '<u>The Law and Practice of Income Tax</u>', (4th ed. 1958) and (6th ed. 1969) Vol. I and II, Bombay: Tripathi.

Khamna, K.C., 'Incidence of Tax and Tax Evasion', (1967) 2nd All India Conference of Tax Executives,F.I.C.C.I.,p.1.

Khanna, K.C., '<u>Investigative High Taxes Make Evasion and Inflation Inevitable</u>', (1968) 4 C.T.B.

Khera,S.S., <u>District Administration in India</u>,London: Asia Publishing House., 1964.

Kher, N.N., '<u>Tax Exemptions in Ancient India</u>', 39, Indian Historical Quarterly, 1963, p.59.

Lakdawala, D.T, <u>Justice in Taxation</u>, Bombay: Popular Book Dept.

Lee, G.A., '<u>Taxation of Income in New Zealand</u>', (1955) 9, B.I.F.D. 270.

Lipton, Paul P. '<u>Current Problems in Tax Fraud</u>', (1955) Wis. L.R. 416.

Longman, P. St.J., '<u>Maxwell on the Interpretation of Statutes</u>', 12th ed. London: Sweet and Maxwell, 1969.

Lyton, Charles, '<u>The Crime of Income Tax Fraud: Its Present Status and Function</u>. 53, Col. L.R. 1953.

Malone, Allen, T., '<u>Income Splitting as a Means of Avoiding Taxes</u> , (1965-66) Vend. L.R. 1289, see also (1967) 2 I.T.J.

Mann, F.A.A. '<u>The Legal Aspects of Money</u>,'LL.D Thesis, University of London, 1938.

Mannan, J.P. and Farnsworth, E., '<u>The Principles of Income Taxation</u>', London: Stevens and Sens, 1953.

Mannheim, Hermann, '<u>Criminal Justice and Social Reconstruction</u>', London: Kegan Paul, Trench, Trubner & Co. Ltd., 1946.

McDonald, John A., '<u>Canadian Income Tax: A Treatise on the Income Tax Law of Canada</u>. (ed. by Martin L. O'Brien) , Toronto: Butterworth (1957 up to date 1970).

McGregor, '<u>Around the Courts</u>', (1968) 16 Can T.J. 262.

McGregor G., '<u>Interpretation of Taxing Statutes: Whither Canada</u>? (1968) 16 Can T.J. 122.

Mentz, J.R., '<u>Collateral Estoppel in Tax Fraud Proceedings</u>', (1965) 51 Virg. L.R. 1360.

Merrillat, H.C.L., '<u>Land and the Constitution in India</u>. New York and London. Columbia University Press, 1970.

Mill, John Stuart, '<u>Essays on Some Unsettled Questions of of Political Economy</u>', London, 1948.

Mukherji, B.K.,'<u>The Hindu Law of Religious and Charitable Trusts</u>.' (Tagore Law Lectures 1936), 2nd ed., Eastern Law House, Calcutta, 1962.

Mulla, Sir, D.F., '<u>Transfer of Property Act, 1882</u>. Calcutta: Eastern Law House, 1933.

Murphy, Joseph H., '<u>The Investigative Procedure for Criminal Tax Evasion</u>, (1958) 27, Fordham, L.R., p.48.

Mutwami, Kewal, '<u>Manu Dharma Sastra</u>', Madras, Ganesh and Co.

Narayan, Sriman, '<u>Socialism in Indian Planning</u>,' Bombay: Asia Publishing House, 1964.

Nath, Onkar, '<u>Taxpayers' Education</u>' (1968) 3rd All India Conference of Tax Executives, F.I.C.C.I. 137.

Niyogi, J.P., '<u>Evolution of the Indian Tax System</u>', Studies in Economic and Political Science No. 12, London School of Economics, London, 1929.

Oppe, S., <u>Wharton's Law Lexicon</u>, 4th ed., London, Stevens and Sons, 1958.

Oslo, K.S., '<u>Legislative Measures to Fight Tax Frauds in Norway</u>', (1953) 7 B.I.F.D. 258.

Pal, Debi Prasad, '<u>Social Effects of Fiscal Legislation with Special Reference to Devaluation</u>', 3, J.I.L.I., West Bengal State Unit.

Pannuswami, K., '<u>Registration of Firms: Some Problem</u>', (1964) 6, J.I.L.I. 54.

Paphale, G.L., <u>A Quarter a Century of Direct Taxes in India 1939-64</u>, Economic Research and Training Foundation (Research Publication Series 6). 1965.

Paul, Randolph E. and Marten, Jacob, '<u>The Law of Federal Income Tax</u>, Vol. 5, Chicago: Collaghan and Co. 1934.

Paul, Randolph, E.,'The Responsibility of Tax Adviser', (1950) 63, Harv. L.R. 377.

Perry, David B., 'Fiscal Figures', (1969) 17, Can. T.J. 207.

Peter, J.H. Jenkin, 'Tax Reform Proposals in New Zealand', (1968) 16 Can. T.J. 146.

Philips, A.O., 'Nigerian's Tax Efforts', (1970) B.T.R. 180.

Pound, Roscoe, Jurisprudence, Vol.5. St. Paul Minn. West Publishing Co., 1959.

Price, Leolin, 'More About Unclean Hands', (1959) B.T.R. 229 and 499.

Ralph S. Rice,'Judicial Techniques in Combating Tax Avoidance', (1953) 51 Mich. L.R. 1021.

Ranchhoddas, Raetanlal and Thakore, D. Kheshavlal, 'The Law of Evidence', 8th ed., Bombay: The Bombay Law Reporter, 1939.

Rao, Venugapala, 'Facets of Crime in India', New Delhi: Allied Publishers.

Redlich, Norman,'Searches, Seizures and Self-Incrimination', (1955) 10 T.L.R. 191.

Rice, S. Ralph, 'Judicial Techniques in Combating Tax Avoidance', (1952-53) Mich. L.R. 1021.

Rudick, J. Hurry, 'The Problem of Personal Income Tax Avoidance, (1940) 7 L.C.P. 243.

Sahota, G.S., '<u>Indian Tax Structure and Economic Development</u>', Institute of Economic Growth, Bombay. Asia Publishing House.

Sanagan, D. Gerald,'<u>The Conduct of Taxing Statutes</u>', (1940) 18, Can. B.R. 43.

Sarkar, Latika and Kelkar, R.V., '<u>Nature of Criminal Law and Criminal Proceedings: Mens rea and Economic Crimes</u>', (1965) 7, J.I.L.I. 462.

Sarkar, S.C., '<u>Law of Evidence</u>', 9th ed. Calcutta: S.C. Sarkar, 1953.

Scott, Austin Walkeman, '<u>Colateral Estoppel by Judgement</u>'. (1942) 56 Harv. L.R.I.

Setalvad, M.C. and Satalvad, A.M., '<u>Mulla on the Transfer of</u> Property. 5th ed. N.M. Tripati. Bombay.

Sethi, P.C., '<u>Inaugural Address</u>', 4th All India Conference of Tax Executives, F.I.C.C.I. 6.

Sharma, G.C.,'<u>New Law Regarding Registration of Firms</u>', Tax Consultant Conference, Souvenir, Jaipur, 1964, p.115.

Shastri, L.B., '<u>Speeches of Prime Minister</u>', Ministry of Information and Broadcasting, Government of India.

Silke, A.S., <u>Silke on South African Income Tax</u> , 5th ed., Johannesburg: Jute and Co. Ltd., 1967.

Sills, David L. (ed.), <u>International Encyclopedia of Social Sciences</u>, Vol. 15, New York: The Macmillan Company and the ____ Free Press, 1968.

Singleton, J.E.,'Conduct at the Bar and Some Problems of Advocacy (6th Impression), London: Sweet & Maxwell Ltd.

Sitrick, B. James, 'Section 367 and Tax Avoidance', (1970) 25 T.L.R. 429.

Smith Adam, 'Inquiry into the Nature and Causes of Wealth of Nations', Book I-III (with an introduction by Skinner, A.) London: Harmondsworth, 1970.

Smith, Turner, L., 'Policies and Procedures in Income Tax Fraud - Cases. (1949-51) 21 Tenn. L.R. 498.

Sontheimer, G.D.,'The Joint Hindu Family: Its Evolution as a Legal Institution', (Ph.D. Thesis, University of London) 1965.

Southeimer, Gunther - Dietz,'Religious Endowments in India: The Juristic Personality of Hindu Deities', (1965) 7 Zeith schrift für, Vergleichende Rechswissenschoff. (A German Journal), p. 45.

Srisivasar, S., 'Advance Tax- Legal amd Procedural Problems', 4th All India Conference of Tax Executives, p.185.

Stamp, Sir Josiah,'The Fundamental Principles of Taxation in the Light of Modern Developments', (The New March Lectures for 1919), London: Macmillan and Co, 1921.

Stephens, Sir James,'A Digest of the Law of Evidence', 12th ed. (by Stephen, Sir Harry Lushington), London: Macmillan and Co. 1936.

Sundaram, V.S.,'The Law of Income Tax in India', (4th ed. 1936, and 7th ed. 1954) Calcutta: Butterworth and Co. India, Ltd.

Surray, Stanley S., 'Federal Income Tax Reform (1970) 84, Harv. L.R. 352.

______ 'Tax Incentive as a Device for Implementing Government Policy: A Comparison with Direct Govt. Expenditure'. (1970) 33 Mod. L.R. 705.

Unger, J., 'Criminal Sanctions in Economic Law', Published in British Legal Papers, (4th-9th August, 1958).

Upadhya, M.L., 'Some Legal Aspects of Agrarian Reform in India', (Ph.D. thesis, University of London, 1970).

Vallibhoy, P.H., 'Tax Payer's Education' 3rd All India Tax Tax Executives Conference. (1968) F.I.C.C.I. 125.

Varma, R.N., 'A Plea for Tax on Casual Income', (1964) Tax Consultant Souvenir (Jaipur) p. 137.

Venkataratnam, B., 'Taxpayer's Education', 3rd All India Conference of Tax Executives, (1968) F.I.C.C.I 131.

Wallace, Gerald G., 'Penalties and Prosecutions For Evasion of the Federal Income Tax', (1946) I.T.L.R. 329.

Walsh, Cliford, 'The Dictionary of English Law, Vol.I. London: Sweet and Maxwell, 1959.

Wheatcroft, G.S.A., 'Attitude of the Legislature and the Courts to Tax Avoidance', (1955) 18 Mod. L.R.. 209.

______ 'British Tax Encyclopedia' Vols. I to V, London, Sweet and Maxwell, 1971.

Whiteman, G. Peter, 'The Meaning of the term Arrangement'. (1966) B.T.R. 399.

Whiteaker, Raymond,'<u>Federal Income Taxes and Civil Fraud Penalties</u>', (1954) 7 Vend. L.R. 366.

Whitemore, Harry, '<u>The Role of the Lawyer in Administrative Justice</u>', (1970) 33, Mod. L.R. 481.

Wolf, Hurst, G., '<u>The Burden of Proof in Tax Disputes</u>', (1970) 18 Can T.J.I.

<u>A.I.R. Commentaries: Criminal Procedure (5 of 1898)</u> 5th ed. Vol.III, Nagpur, 1961.

'<u>Bias Against Tax Evaders</u>', The Economic Weekly, (Bombay), Sept 27, 1958 p. 1234.

<u>Corpus Juris Secundum</u>, Vol. 83, New York: American Law Book Co. 1953.

<u>Criminal Liability for Evasion of Federal Income Taxes</u>, A.M.S. 86 L. ed. (1941) p. 392.

'<u>Criminal Law: Former Jeopardy: Conviction for False Return of Income No Bar to Civil Action for Penalty</u>', (1933-34) 47 Harv. L.R. 1438.

'<u>Economic Crimes in the Soviet Union</u>', (1964) 5 J.I.C.J.I.

'<u>Evading Tax Evasion</u>',Economic Weekly, (Bombay), (Sept.24, 1960) p.1422.

'<u>Evasion of Income Tax</u>', (1941) 57 L.Q.R 458.

'<u>Evasion of Tax</u>', (1942), 58 L.Q.R. 168.

<u>German Tax Avoidance: Looking at Loopholes</u>', 211, Economist (27th June, 1964).

<u>Halsburys Laws of England</u>, Volumes 20,25,26. 3rd ed. (Simons's Edition) London: Butterworth and co. 1958.

'Hazard of Food Adulteration', Souvenir; Bherat Sewak Samaj, New Delhi, (4th October, 1964).

'Incidence of Taxes and Social Service Benefits in 1968: Economic Trends. London: Treasury Publication, 1969.

'Income Tax for the Layman, 6th ed. The Directorate of Inspection. Central Board of Revenue, New Delhi, 1966.

'Mr. Kaldor's Plan for the Reform of Indian Taxation', The Economic Journal, Vol.68, (1958) 160.

Phipson on Evidence, 11th ed. London: Sweet and Maxwell 1970.

'Prevention of Legal Evasion' (1945) 61 L.Q.R. 228.

'Real Income 'Lawyer , (Provincial Bar Association, Madras) 1963.

'Right of Federal Government to Appeal, Adverse Criminal Decisions: The Supreme Court, 1969 Term, (1969-70) 83 Harv. L.R.

Taxation in India, World Tax Series: Harvard Law School: International Programme in Taxation, 1960.

Taxation of Foreign Investment, National Council of Applied Economic Research, New Delhi, 1966.

'Taxation and Private Investment', National Council of Applied Economic Research, New Delhi, 1961.

'Tax and Social Benefits', 'The Accountant', March 12, Vol. 162 (No. 4569) 1970.

'Taxation in the United States': World Tax Series: Harvard Law School: International Programme in Taxation 1963.

'The Crime of Income Tax Fraud: Its Present Statutes and Functions,' (1953) 53, Col. L.R. 476.

'The Times, March 5, 1971, p. 21.

'The Use of the Tax System to Achieve Economic and Social Objectives', (1967) 15 Cam. T.J. 103.

'Webster's International Dictionary, London, George Bell & Sons, 1903.

OFFICIAL PUBLICATIONS

Ceylon. Taxation Inquiry Commission Report 1968. Colombo: Government Printer.

______ Report of the Taxation Commission, 1955. Colombo. Government Printer.

Canada. Report of the Royal Commission on Taxation, 1966, Vol.III, Ottawa: Queen's Printer.

India, Lok Sabha. Select Committee on the Income Tax Bill, 1961, New Delhi.

______ Ministry of Finance, Report of the Indian Taxation Enquiry Committee (1924-25), Vol.I, Vol.II & Vol.III.

______ Ministry of Finance, Report of the Income Tax Investigation Commission, 1949, New Delhi.

______ Ministry of Finance, Report of the Taxation Enquiry Commission 1953-54, Volumes I,II and III.

______ Ministry of Finance, Indian Tax Reform; 1956 (by Nicholas Kaldor). New Delhi.

______ 'Report on Tax Administration in India: A Tax Assistance Survey, U.S.I.R.S., U.S. A.I.D India 1964.

India, Ministry of Finance, Report of Direct Taxes Administration Enquiry Committee (1958-59), New Delhi.

——— Ministry of Finance, Report on Rationalisation and Simplification of the Tax Structure, 1968.(by Bhothalingam).

——— Administrative Reforms Commission: Report of the Working Group on Central Direct Taxes Administration, (1968), New Delhi.

——— Administrative Reform Commission; Report on Central Direct Taxes Administration, 1969, New Delhi.

——— Ministry of Home Affairs; Report of the Committee on Prevention of Corruption, 1964. New Delhi.

——— Ministry of Law; Report of Law Commission, 12th, 14th, 29th; 1958 and 1966, New Delhi.

——— Planning Commission; First, Second and Fourth Five Year Plans, Govt. Printer: New Delhi.

——— Public Accounts Committee, 21st Report 1963-64 (Third Lok Sabha); 2nd and 3rd Report 1967-68 , (4th Lok Sabha).

Israel, Report of the Director of the State Revenue: State of Israel, (March 3, 1965).

Kenya, Report of the Taxation Enquiry Committee: Kenya: 1947, Nairobi.

U.K. Royal Commission of Income Tax: Minutes of Evidence, Cmd 288 - 2 (1919), H.M.S.O., London.

_____ Report of the U.K. Royal Commission on the Income Tax, 1920. Cmd. 615, H.M.S.O., London.

_____ Royal Commission on the Taxation of Profits and Income. Final Report, 1955. H.M.S.O., London.

_____ The British System of Taxation. Central Office of Information. Reference Pamphlet 10: 1966. H.M.S.O., London.

112th Report of the Commissioners of H.M. Inland Revenue: 1969, London, H.M.S.O.

United Nations, Report of the Seminar on Administration of Income Tax in African Countries, United Nations, (1968).